No. 4043

United States

19

Circuit Court of Appeals

For the Ninth Circuit.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

ALBERT C. SMITH,

Appellant,

vs.

EARL C. BRONAUGH, Trustee in Bankruptcy of the Estate of MORRIS BROTHERS, INC., Bankrupt,

Appellee.

Transcript of Record.

Upon Appeal from the United States District Court for the District of Oregon.

Filmer Bros. Co. Print, 330 Jackson St., S. F., Cal.

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INDEX TO THE PRINTED TRANSCRIPT OF RECORD.

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

Index.

Names and Addresses of Attorneys of Record.

Mr. I. N. SMITH, Platt Building, Portland, Oregon; Mr. L. A. McNARY, Gasco Building, Portland, Oregon; and Mr. JOHN W. REYNOLDS, Northwestern Bank Building, Portland, Oregon,

For the Appellant.

Mr. J. P. WINTER, Title & Trust Building, Portland, Oregon,

For the Appellee.

Citation on Appeal.

United States of America,
District of Oregon,—ss.

To E. C. Bronaugh, Trustee in Bankruptcy of Morris Brothers, Inc., and to John P. Winter, Esq., His Attorney, GREETING:

WHEREAS, Albert C. Smith has lately appealed to the United States Circuit Court of Appeals for the Ninth Circuit from a decree rendered in the District Court of the United States for the District of Oregon, in your favor, and has given the security required by law;

You are, therefore, hereby, cited and admonished to be and appear before said United States Circuit Court of Appeals for the Ninth Circuit, at San Francisco, California, within thirty days from the date hereof, to show cause, if any there be, why the said decree should not be corrected, and

speedy justice should not be done to the parties in that behalf.

GIVEN under my hand, at Portland, in said District, this 16th day of August, in the year of our Lord one thousand nine hundred and twenty-two.

CHAS. E. WOLVERTON,
Judge.

State of Oregon,
County of Multnomah,—ss.

Due service of the within citation on appeal is hereby accepted in said county and state this 16th day of August, 1922, by receiving a copy thereof, duly certified to be such by John W. Reynolds, of attorneys for appellant.

J. P. WINTER,
Attorney for Trustee in Bankruptcy.

[Endorsed]: (Original). No. B—5653. United States District Court, District of Oregon. In the Matter of Morris Brothers, Inc., Bankrupt. In re Claim of Albert C. Smith. Citation on Appeal. U. S. District Court, District of Oregon. Filed Aug. 16, 1922, at 2 o'clock P. M. G. H. Marsh, Clerk. [1*]

*Page-number appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States for the District of Oregon.

March Term, 1922.

BE IT REMEMBERED, That on the 6th day of April, 1922, there was duly filed in the District Court of the United States for the District of Oregon, the certificate of the Referee in Bankruptcy for review by the Court of the order of the Referee disallowing the claim of Albert C. Smith, in words and figures as follows, to wit: [2]

In the District Court of the United States for the District of Oregon.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Certificate on Review of Order Disallowing Claim of Albert C. Smith.

To the Honorable District Court Above Named:

The undersigned Referee in Bankruptcy before whom the administration of said estate is pending, hereby certifies that on the 12th day of January, 1922, an order was made and entered in said cause denying to Albert C. Smith his claim, either general or preferred, against the estate of the above-named bankrupt; that thereafter the said petitioner, being aggrieved at the order so made, filed his petition for review which was allowed, and the question for decision upon said review is whether or not the order made is correct under the pleadings and proof.

The reasons for the order and principles of law applicable are fully set forth in the order and need not, in this certificate, be repeated.

I hand up with this certificate as a part thereof
The petition and claim.
The answer thereto.
The order disallowing the claim.
The petition for review.
All the pleadings and the evidence adduced before me.

Respectfully submitted,
A. M. CANNON,
Referee in Bankruptcy.

Filed April 6, 1922. G. H. Marsh, Clerk. [3]

AND AFTERWARDS, to wit, on the 6th day of April, 1922, there was duly filed in said court, with the certificate of the Referee, the claim of Albert C. Smith, in words and figures as follows, to wit: [4]

In the District Court of the United States for the District of Oregon.

IN BANKRUPTCY.

In the Matter of MORRIS BROTHERS, INC., a Corporation, Bankrupt.

Petition and Claim of Albert C. Smith.

Comes now Albert C. Smith, the petitioner, and respectfully represents to this Honorable Court and alleges:

I.

That on and prior to the 6th day of September, 1919, Morris Brothers, Inc., was a corporation, organized under the laws of the State of Oregon, and that the stockholders of the said corporation, on said 6th day of September, 1919, adopted a resolution that the said corporation be dissolved, and also adopted a resolution authorizing and directing the directors to dissolve said corporation and to sell all the assets and business thereof for a consideration of one million and 00/100 dollars ($1,000,000.00) to a new corporation of the same name to be formed, and the directors thereupon, on said day, held a meeting and adopted a resolution of dissolution of said corporation and sale of its business and assets for one million and 00/100 dollars ($1,000,000.00) to a new corporation of the same name to be organized, as directed by said resolution of the stockholders.

II.

That thereafter, a new corporation, to wit, Morris Brothers, Inc., the bankrupt above named, was organized, and on said 6th day of September, 1919, held its first meeting of stockholders; and at said meeting of stockholders it was resolved that the offer of Morris Brothers, Inc., said antecedent corporation, to sell all its assets and business to the said new corporation for one million and 00/100 dollars ($1,000,000.00) be accepted; and thereafter, on [5] the same day, the first meeting of the Board of Directors of said new corporation was held, and a resolution was by said directors

adopted approving and ratifying said action of the stockholders.

III.

That said Morris Brothers, Inc., existing previous to September 6, 1919, had a capital stock consisting of common stock only of one hundred thousand and 00/100 dollars ($100,000.00), and all of said stock at the time of said dissolution was held by Stella M. Etheridge, except one share of one hundred and 00/100 dollars ($100.00) par value held by J. L. Etheridge, one share of one hundred and 00/100 dollars ($100.00) par value held by F. S. Morris, and one share of one hundred and 00/100 dollars ($100.00) par value held by Forbes B. Pratt; and that said new corporation was organized with an authorized capital stock of one million and 00/100 dollars ($1,000,000.00), five hundred thousand and 00/100 dollars ($500,000.00) preferred stock and five hundred thousand and 00/100 dollars ($500,000.00) common stock, and that all of said stock was formally subscribed by said Stella M. Etheridge, except one share of one hundred and 00/100 dollars ($100.00) common stock which was subscribed by said Forbes B. Pratt and one share of one hundred and 00/100 dollars ($100.00) common stock which was subscribed by J. L. Etheridge.

IV.

That the dissolution of said antecedent corporation and the organization of said new corporation of the same name was a formal and apparent change only, and that in truth and in fact and in

legal effect, the persons concerned therein remained the same, and the property, obligations, assets and business thereof continued the same, and the sole effect thereof was to authorize the increase of capital stock to five hundred thousand and 00/100 dollars ($500,000.00) common stock and five hundred thousand and 00/100 dollars ($500,000.00) preferred stock; and all transactions hereinafter alleged of a date prior to September 6, 1919, refer to transactions with said antecedent corporation, and all allegations with reference to transactions subsequent to September 6, 1919, refer to [6] transactions with said reorganized corporation.

V.

That on or about the 31st day of July, 1919, said Morris Brothers, Inc., had and received money to and for the use and benefit of petitioner in the manner hereinafter more particularly stated.

VI.

That on or about the 31st day of July, 1919, said stockholders and said Morris Brothers, Inc., by its officers and agents, falsely and fraudulently represented to petitioner that said Morris Brothers, Inc., had for sale and would sell petitioner preferred stock of said Morris Brothers, Inc.; that the common stock in said corporation was paid up and was represented by cash, bonds and other property of the value of five hundred thousand and 00/100 dollars ($500,000.00), and that said preferred stock was better than municipal bonds;

that the same could be easily sold, and would pay dividends of eight per cent (8%) per annum, and that six per cent (6%) per annum would be guaranteed; and that said offer was made to him and to a few other influential customers as a special favor and opportunity, and that when the preferred stock was fully sold the paid-up capital of said corporation would be one million and 00/100 dollars ($1,000,000.00).

VII.

That petitioner believed and relied upon said representations, and that said representations were all made for the purpose of inducing petitioner to pay money to said Morris Brothers, Inc., in the attempted purchase of preferred stock, above described, and did induce petitioner, on or about the 31st day of July, 1919, to pay to said Morris Brothers, Inc., the said sum of two thousand and 00/100 dollars ($2,000.00), as evidence of which payment petitioner received interim certificate No. 838, a copy of which is hereunto [7] attached marked Exhibit "A."

VIII.

That in truth and in fact, Morris Brothers, Inc., was not, at the time of said representations to petitioner, nor at any time, a corporation of five hundred thousand and 00/100 dollars ($500,000.00) paid-up common stock, or having any amount of authorized capital stock except one hundred thousand and 00/100 dollars ($100,000.00) common stock, as above described, but in truth

and in fact, there was not and never had been more than one hundred thousand and 00/100 dollars ($100,000.00) paid up as capital stock of said Morris Brothers, Inc., nor was there any money or property representing paid-up capital or surplus or assets above its liabilities belonging to said Morris Brothers, Inc., at said time; that in truth and in fact, said preferred stock offered to petitioner was not more valuable or better or more saleable than municipal bonds, nor was the same of any value whatever; that in truth and in fact, no such preferred stock was in existence, nor legally or at all authorized to be issued or subscribed.

IX.

That prior to the time of said representations to petitioner, all of said stockholders of Morris Brothers, Inc., conspired and confederated together for the purpose of permitting the withdrawal, by said Fred S. Morris, of assets of said corporation of the value of more than one hundred thousand and 00/100 dollars ($100,000.00) and more than the entire amount of paid-up capital and surplus assets then belonging to said corporation; and that said Stella M. Etheridge, in pursuance of said conspiracy and fraudulent purpose, acquired all of the capital stock of said corporation then belonging to or within the control of said Fred S. Morris, and in consideration thereof, said Fred S. Morris was, in pursuance of said conspiracy and fraudulent purpose, permitted [8] to and did withdraw and receive from the

assets of said corporation more than one hundred thousand and 00/100 dollars ($100,000.00) in value thereof, and more than the entire capital and surplus then belonging to said corporation.

X.

That at and prior to the time of said withdrawal of assets by said Fred S. Morris, the fraudulent purpose was conceived by all of said stockholders to reorganize said corporation with an authorized capital of five hundred thousand and 00/100 dollars ($500,000.00) preferred stock, and that said common stock and also said preferred stock, with the exception of a nominal amount thereof, should be subscribed by said Stella M. Etheridge and issued to her as fully paid stock without other payment of such subscriptions except the transfer of the assets of said antecedent corporation to said reorganized corporation; and in pursuance of said conspiracy and fraudulent scheme, said antecedent corporation was thereafter dissolved and said new corporation formed, and the assets of said antecedent corporation transferred to said new corporation, and all of said common stock in the new corporation subscribed by said Stella M. Etheridge except one hundred and 00/100 dollars ($100.00) thereof subscribed by Forbes B. Pratt and one hundred and 00/100 dollars ($100.00) thereof subscribed by J. L. Etheridge, and said stock was, in further pursuance of said scheme, issued to said Stella M. Etheridge as fully paid, excepting two hundred and 00/100 dollars ($200.00) thereof, as aforesaid; and in further pursuance of said fraudulent

scheme, said five hundred thousand and 00/100 dollars ($500,000.00) preferred stock was all subscribed by said Stella M. Etheridge and issued to her as fully paid and nonassessable; and that no payment of any of the said stock subscriptions was in fact made, except that said new corporation succeeded to the assets and liabilities and the business of said corporation so dissolved. [9]

XI.

That said Stella M. Etheridge did not have, at the time of subscribing said stock, nor has she had at any time since, any property or means of paying said subscriptions, either of common or preferred stock, or any part thereof; and that all of said stockholders well knew, at the time said subscription was received, that said Stella M. Etheridge was unable to pay anything thereon, and that she was insolvent; and that the subscription of said stock by said Stella M. Etheridge, she being without financial responsibility, was a part of said fraudulent scheme to reorganize said corporation on the basis of five hundred thousand and 00/100 dollars ($500,000.00) common stock and five hundred thousand and 00/100 dollars ($500,000.00) preferred stock without any actual capital whatever, except such as might be obtained by fraudulent sales of preferred stock in like manner as practiced against petitioner, as above set forth.

XII

That during a period beginning in the year 1918 and extending until the date of reorganization of

said corporation in September, 1919, purported and pretended sales of preferred stock of Morris Brothers, Inc., were made to other persons in like manner as to the petitioner, all in pursuance of the same plan and purpose, as above set forth, and that all of the sums received by said pretended sales of preferred stock were carried in a distinct account upon the books of said Morris Brothers, Inc., both prior to and after said reorganization date, including said sum of two thousand and 00/100 dollars ($2,00.00) so fraudulently obtained from the petitioner, as aforesaid; and when said new corporation had been organized and said preferred stock issued to said Stella M. Etheridge, the said Stella M. Etheridge surrendered for delivery to the petitioner and other persons fraudulently induced, as aforesaid, to become purchasers of [10] said preferred stock, sufficient shares thereof to satisfy said pretended sales; and thereupon, the said Stella M. Etheridge was given credit on the books of said corporation for the entire amount which has been received and was then standing to the credit of sales of preferred stock in said Morris Brothers, Inc., and said Stella M. Etheridge immediately received therefor, as representing the proceeds of the sales of her said preferred stock, certain bonds, to wit:

Ten thousand and 00/100 dollars ($10,000.00) par value six per cent (6%) bonds of the City of Victoria, B. C., due March 1st, 1928;

Fifteen thousand and 00/100 dollars ($15,000.00) par value six per cent (6%) bonds of the City of

Regina, Province of Saskatchewan, due March 1st, 1923;

Twenty-five thousand and 00/100 dollars ($25,000.00) par value six per cent (6%) bonds of Caribou County, Idaho, due may 1st, 1936, to May 1st, 1938;

Twenty-five thousand and 00/100 dollars ($25,000.00) par value five and one-half per cent (5½%) bonds of Teton County, Idaho, due July 1st, 1936 to July 1st, 1938;

Twenty-five thousand and 00/100 dollars ($25,000.00) par value five and one-half per cent (5½%) bonds of Clarke County, Washington;—the total value of said bonds, on the date of said transfer, to wit, on or about the 16th day of February, 1920, being one hundred two thousand, seven hundred fifty-one and 18/100 dollars ($102,751.18) including interest then accrued; and subsequent thereto, said Stella M. Etheridge exchanged said twenty-five thousand and 00/100 dollars ($25,000.00) Clarke County, Washington, bonds for twenty-five thousand and 00/100 dollars par value six per cent (6%) bonds of the city of Twin Falls, Idaho, due January 1st, 1936, said exchange being made August 21st, 1920; and the value of said Twin Falls bonds with interest then accrued was [11] twenty-five thousand two hundred eight and 32/100 dollars ($25,208.32), said value being more than covered by the value of said bonds of said Clarke County, Washington, exchanged therefor.

XIII.

That the said Stella M. Etheridge had and retained in her possession and control until the time of the appointment of the Receiver herein, all of said bonds so acquired and representing the money paid by petitioner and others defrauded in like manner by the pretended sales of preferred stock, as aforesaid, except the said bonds of Clarke County, Washington, and in lieu thereof, she so held continuously to said date of receivership herein, said bonds of Twin Falls, Idaho, and that all of said bonds so held by her to the date of receivership herein were surrendered to said receiver, and came into possession of said Trustee, and have at all times been capable of identification.

XIV.

Petitioner is informed and believes and therefore alleges, that said Trustee has sold the said twenty-five thousand and 00/100 dollars ($25,000.00) par value Teton County, Idaho, bonds and ten thousand and 00/100 dollars ($10,000.00) par value of said Twin Falls, Idaho, bonds, and that the remainder of said bonds remain undisposed of in the hands of said Trustee.

XV.

That the value of said bonds and the proceeds of sale thereof in the hands of said Trustee greatly exceeds the entire amount of the claims of petitioner and all other persons defrauded by the pretended sale of preferred stock, as aforesaid, now unsatisfied.

XVI.

That after the payment by petitioner of said two thousand and 00/100 dollars ($2,000.00) in the attempted purchase of [12] preferred stock, as aforesaid, petitioner received from Morris Brothers, Inc., payment of interest on said two thousand and 00/100 dollars ($2,000.00) at eight per cent (8%) from said 31st day of July, 1919, to the 1st day of July, 1920, said payments aggregating $146.67; that said sums were offered to petitioner under the guise of dividends on preferred stock, but that petitioner, at the time of accepting the same, had no knowledge or information of any of the facts hereinbefore set forth, nor that any of the representations made to him as aforesaid, were untrue, and that petitioner did not know or have any information of any of said facts, nor of any of said misrepresentations being untrue until a short time prior to the filing of this petition, nor until during the pendency of the above-entitled cause in bankruptcy; and that petitioner surrendered his interim certificate, aforesaid, and received in exchange a pretended certificate of preferred stock on or about the 13th day of January, 1920, but said certificate of preferred stock was also received and accepted by petitioner without any knowledge that any of said representations were untrue and without any knowledge of the facts above alleged. That said sums so pretended to be paid as dividends on the said preferred stock, were not in fact dividends; that at the time of the payment thereof, the said Morris

Brothers, Inc., was insolvent and had no earnings from which or with which to pay dividends; that such pretended dividends were paid by Morris Brothers, Inc., to petitioner to induce him to believe and he did believe therefrom, that his alleged preferred stock was of great value and was fully paid and nonassessable, and that petitioner was lulled to repose and thereby induced to forbear inquiry into the true condition of said preferred stock by such false and spurious payment of alleged and pretended dividends on such stock; that the officers of said bankrupt well knew at the time of the payment of the pretended dividends on such preferred stock, that [13] the said corporation was and at all times herein mentioned had been insolvent, and that such pretended payment of dividends was a sham and a subterfuge and was a fraud upon petitioner and others, and with such knowledge the said officers of said bankrupt, paid such pretended dividends to this petitioner to further defraud and deceive him and he was defrauded and deceived thereby.

XVII.

That this petitioner has heretofore filed his claim against said bankrupt estate as a general creditor thereof, but that said claim was presented prior to any knowledge or means of knowledge on petitioner's part of any of said facts above alleged as to the method of organization of said corporation, or as to the manner in which said pretended preferred stock was subscribed or issued, nor as to what disposition was made of the funds received

therefrom, or that said funds were traceable, or that the same, or property received therefor could be traced or identified.

XVIII.

That petitioner is ready, able and willing to do and perform whatever the Court shall deem equitable in the matter of restoration of said pretended dividends, surrender of said worthless preferred stock certificate, or otherwise.

XIX.

That no portion of said sum so paid by petitioner has been repaid, nor any interest thereon paid to him, except as above set forth; that there are no setoffs or counterclaims thereto; that no judgment has ever been recovered thereon, and that petitioner has not, nor has any person by his order or to his knowledge or belief, for his use, had or received any manner of security therefor.

WHEREFORE, petitioner prays that he be allowed his amended claim as herein set forth for the sum of two thousand and 00/100 dollars ($2,000.00), with interest at six per cent (6%) per annum [14] from the 31st day of July, 1919, subject to credit of $146.67 on said interest, that said bonds and the proceeds thereof be declared a trust fund for the payment of claims of petitioner and of others in like situation, and that petitioner be decreed and awarded a prior lien therefor upon the bonds above described and upon the proceeds of any of said bonds which may have been disposed of by said trustee in bankruptcy, and that said trustee be required to report and

disclose what disposition or sales, if any, have been made of any of said bonds above described, and the dates thereof, and the sums realized by such sales; and that said bonds and proceeds thereof, be set aside and disposed of under the direction of the court for the payment, to petitioner, of the amount of his said claim and for the payment *pro rata* of such others as shall show themselves entitled to liens thereon upon like basis with petitioner. That the trustee be directed and ordered to keep said bonds and their proceeds distinct and not to confuse or intermingle the same with general assets in the hands of said trustee. That petitioner may have such other and further relief as may be just and equitable in the premises.

ALBERT C. SMITH,
Petitioner.

I. N. SMITH,
JOHN W. REYNOLDS,
L. A. McNARY,
Attorneys for Petitioner.

State of Oregon,
County of ——,—ss.

I, Albert C. Smith, being first duly sworn, say that I am the petitioner in the foregoing petition; and that said petition is true, as I verily believe.

ALBERT C. SMITH.

Subscribed and sworn to before me this 20th day of June, 1921.

[Seal] P. H. D'ARCY,
Notary Public for Oregon.

My notarial commission expires November 18th, 1924. [15]

Exhibit "A."

MORRIS BROTHERS, INC.

INTERIM CERTIFICATE. No. 838

Portland, Oregon, August 1, 1919.

Upon the surrender of this Certificate, properly endorsed, we will deliver to Mr. Albert C. Smith or order $2,000.00—Two Thousand and no/100 Dollars—6% Morris Brothers, Inc., Preferred Stock bonds due —— optional —— 19—, —— with —— and subsequent coupons attached, if when and as said bonds are issued and delivered to us.

In the event said bonds shall not be issued and delivered to us, we will redeem this certificate for Two Thousand and no/100 Dollars ($2,000.00), and the interest which would have accrued on the bond since August 1st, 1919, but such interest will cease thirty days after we transmit notice to the above-named holder that the bonds will not be issued.

[Seal] By JOHN L. ETHERIDGE,
Treasurer.

State of Oregon,
County of Multnomah,—ss.

Due service of the within petition and claim of Albert C. Smith is hereby accepted in Multnomah County, Oregon, this —— day of June, 1921, by receiving a copy thereof, duly certified to as such

by John W. Reynolds, one of the attorneys for petitioner.

J. P. WINTER,
Attorney for Trustee.

Filed June 21, 1921. A. M. Cannon, Referee in Bankruptcy. Filed April 6, 1922. G. H. Marsh, Clerk. [16]

AND AFTERWARDS, to wit, on the 6th day of April, 1922, there was duly filed in said court, with the certificate of the Referee, an answer and objections by the Trustee to the claim of Albert C. Smith, in words and figures as follows, to wit: [17]

In the District Court of the United States for the District of Oregon.

B—5653.

In the Matter of MORRIS BROTHERS, INC., a Corporation, Bankrupt.

Answer and Objections to Petition and Claim of Albert C. Smith.

Comes now Earl C. Bronaugh, the duly elected, qualified and acting Trustee of Morris Brothers, Inc., a corporation, bankrupt, and for an answer and objections to the petition of Albert C. Smith filed herein, and on information and belief, admits, denies and alleges:

I.

Admits the allegations contained in Paragraphs I, II, and III of said petition.

II.

Denies any knowledge or information sufficient to form a belief of the allegations contained in Paragraphs IV, V, VI, VII, VIII and IX of said petition, and therefore denies the same, excepting that the Trustee admits that on or about the 31st day of July, 1919, Albert C. Smith did pay Morris Brothers, Inc., the sum of $2,000.00, for which Morris Brothers, Inc., issued its interim Certificate No. 838, a copy of which marked Exhibit "A" is attached to said petition.

III.

Denies any knowledge or information sufficient to form a belief of the allegations contained in Paragraph X of said petition, and therefore denies the same, excepting that the Trustee admits that Stella M. Etheridge subscribed for and that there was issued to her $500,000.00 par value of the preferred stock of Morris Brothers, Inc., for which the said Morris Brothers, Inc., has not received payment. [18]

IV.

Denies any knowledge or information sufficient to form a belief of the allegations contained in Paragraphs XI, XII, XIII, XIV and XV of said petition and therefore denies the same, excepting that the Trustee admits that the divers bonds set out and referred to in said petition came

into his possession as a part of the assets of the bankrupt Estate of Morris Brothers, Inc., and are still in his possession excepting those alleged in said petition to have been sold by the Trustee.

V.

Denies any knowledge or information sufficient to form a belief of the allegations contained in Paragraph XVI of said petition, and therefore denies the same, excepting that the Trustee admits that Morris Brothers, Inc., made payments aggregating $146.67 to the said Albert C. Smith, and that there was issued to the said Albert C. Smith $2,000.00 par value of the preferred stock of Morris Brothers, Inc., and that the said Albert C. Smith is now the owner and record holder of said $2,000.00 par value of the said preferred stock of Morris Brothers, Inc.

VI.

Denies any knowledge or information sufficient to form a belief of the allegations contained in Paragraphs XVII, XVIII and XIX of said petition and therefore denies the same.

The Trustee further answering said petition and for further objections thereto, and for a further and separate defense thereto, and on information and belief, alleges:

I.

That some time prior to the 13th day of January, 1920, Stella M. Etheridge subscribed for and was the owner and record holder of all of the preferred stock of Morris Brothers, Inc., which said

preferred stock subscribed for by the said Stella M. Etheridge [19] had not on the said 13th day of January, 1920, been paid for by her and has not since the said 13th day of January, 1920, been paid for by the said Stella M. Etheridge.

II.

That on or about the said 13th day of January, 1920, the said Stella M. Etheridge transferred and assigned $2,000.00 par value of said preferred stock to Albert C. Smith the petitioner herein, who is now the owner and record holder of said $2,000.00 par value of said preferred stock.

III.

That said $2,000.00 par value of said preferred stock so transferred and so assigned to the said Albert C. Smith by the said Stella M. Etheridge has never been paid for, unless it be determined by this Court at a hearing on said petition, that the $2,000.00 paid Morris Brothers, Inc., on or about the 31st day of July, 1919, by the said Albert C. Smith, as in said petition alleged, has in fact actually accrued to the use and benefit of Morris Brothers, Inc., and in payment for the said $2,000.00 par value of said preferred stock so transferred and assigned to the said Albert C. Smith by the said Stella M. Etheridge as hereinbefore set out.

IV.

That the Trustee is entitled to an order of this Court determining and fixing the amount due the bankrupt Estate of Morris Brothers, Inc., by the

said Albert C. Smith on account of said $2,000.00 par value of the said preferred stock of Morris Brothers, Inc., so transferred and assigned to the said Albert C. Smith by the said Stella M. Etheridge, and the Trustee alleges that the sum of $2,000.00 together with interest thereon, is now due, owing and unpaid the bankrupt Estate of Morris Brothers, Inc., by the said Albert C. Smith, on account thereof, and that the Trustee is entitled to a further order of this Court refusing to permit the said Albert C. Smith to prove [20] any alleged claim against the bankrupt Estate of Morris Brothers, Inc., until he has paid to the Trustee the said sum of $2,000.00, together with interest thereon, which is now due, owing and unpaid the bankrupt Estate of Morris Brothers, Inc., by the said Albert C. Smith, on account of said unpaid stock subscription, as hereinbefore set out.

V.

That if this Court determines at a hearing on said petition, that the said $2,000.00 par value of the said preferred stock of Morris Brothers, Inc., so transferred and assigned to the said Albert C. Smith by the said Stella M. Etheridge, has in fact been paid for by the said $2,000.00 so paid Morris Brothers, Inc., by the said Albert C. Smith, as hereinbefore set out, the Trustee alleges that the said Albert C. Smith has no claim of any sort against the bankrupt Estate of Morris Brothers, Inc., neither a general claim, a priority claim, nor a claim for or against the specific property set out and referred to in said petition.

VI.

That if this Court determines at a hearing on said petition that the said $2,000.00 par value of the said preferred stock of Morris Brothers, Inc., so transferred and assigned to the said Albert C. Smith by the said Stella M. Etheridge, has not in fact been paid for by the said $2,000.00 so paid Morris Brothers, Inc., by the said Albert C. Smith, as hereinbefore set out, the Trustee alleges that any claim, if any, either a general claim, a priority claim, or a claim for or against the specific property set out and referred to in said petition, which the said Albert C. Smith might be able to prove against the bankrupt Estate of Morris Brothers, Inc., would be exactly offset by the claim of the Trustee against the said Albert C. Smith, on account of the said sum of $2,000.00, together with interest thereon, alleged to be now due, owing and unpaid the bankrupt Estate of Morris Brothers, Inc., by the said [21] Albert C. Smith, on account of said unpaid stock subscription, owing on said $2,000.00 par value of the said preferred stock of Morris Brothers, Inc., so transferred and assigned to the said Albert C. Smith by the said Stella M. Etheridge.

WHEREFORE, the Trustee prays for an order dismissing the petition of the claimant herein, and for a further order disallowing any claim of the petitioner, Albert C. Smith, against the bankrupt Estate of Morris Brothers, Inc., growing out of his purchase of any of the preferred stock of

said corporation, and that any such claim on file herein be expunged from the list of claims upon the record in this bankruptcy matter.

EARL C. BRONAUGH,
Trustee.

M. F. DOLPH,
Of Attorneys for the Trustee,
317 Mohawk Bldg.,
Portland, Oregon.

United States of America,
District and State of Oregon,
County of Multnomah,—ss.

Earl C. Bronaugh, being first duly sworn, deposes and says that he is the duly elected, qualified and acting trustee of Morris Brothers, Inc., a corporation, bankrupt; that he has read the foregoing answer, and knows the contents thereof; that the same is true of his own knowledge, except as to matters therein stated on information and belief and as to those matters he believes it to be true.

EARL C. BRONAUGH.

Subscribed and sworn to before me this 1st day of September, 1921.

[Seal] ALICE AGLER,
Notary Public for the State of Oregon.

My commission expires November 4, 1923. [22]

District of Oregon,
County of Multnomah,—ss.

Due service of the within answer and objections

is hereby accepted in Multnomah County, Oregon, this 1st day of September, 1921, by receiving a copy thereof, duly certified to as such by M. F. Dolph, Attorney for Trustee.

I. N. SMITH,
Of Attorneys for Petitioner.

Filed Sept. 14, 1921. A. M. Cannon, Referee in Bankruptcy.

Filed April 6, 1922. G. H. Marsh, Clerk. [23]

AND AFTERWARDS, to wit, on the 6th day of April, 1922, there was duly filed in said court, with the certificate of the Referee, the order of the Referee disallowing claim of Albert C. Smith, in words and figures as follows, to wit: [24]

In the District Court of the United States for the District of Oregon.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Decision and Order in the Matter of the Preferred Claim of Albert C. Smith.

The claimant seeks by petition to have his status as a preferred claimant adjudged by the Court upon the following state of facts:

In July, 1919, Smith was solicited by an agent of Morris Brothers to purchase preferred stock of the corporation. At that time Morris Brothers

was a corporation with an authorized capital of $100,000 common stock only, and without power to sell or issue preferred stock. It was, however, represented to this claimant that the corporation had an authorized capital of $1,000,000, $500,000 of which was common stock and $500,000 preferred; that the common stock of the corporation was fully paid up with cash, bonds or other securities paid in or on hand to represent the same. Believing the representations so made, claimant agreed to purchase $2,000 of this preferred stock. He paid the corporation $2,000 in cash or property and thereupon an interim certificate was issued to him by which Morris Brothers agreed either to issue to him $2,000 preferred stock or repay to him his money. The stock was not issued to him at this time. All these representations were false and are admitted by the trustee to have been.

In September, 1919, a new corporation was formed under identically the same name with an authorized capital of $1,000,000, $500,000 common stock and $500,000 preferred; all, or substantially all, of this stock having been subscribed by one of the stockholders of the old corporation. That institution went through the form of transferring to the new corporation all of its assets in payment of the stock so subscribed and thereupon the stock of the [25] new corporation, both preferred and common, was issued to Stella M. Etheridge, who had subscribed for the same, she being the wife of John L. Etheridge, president and manager of the

old corporation. There was issued to John L. Etheridge and one Pratt sufficient of this stock to qualified them as stockholders and officers of the new corporation.

Some time later Stella M. Etheridge surrendered to the new corporation a considerable portion of the preferred stock issued to her, and thereafter the said corporation proceeded to sell the same and to issue the shares that had been previously purchased by Smith and other persons. Smith's shares were issued to him in July, 1920.

It is also an admitted fact that during all of this time both the old corporation and the new corporation were insolvent and the new corporation was in a continuous state of insolvency from the time of its organization to the date of its adjudication in bankruptcy; also that subsequent both to the time Smith made his purchase and to the time the stock was issued to him the new corporation accumulated obligations in a large amount, totaling at the date of adjudication more than $1,500,000, claims for which, general and preferred, have been filed in this court. The assets are far from sufficient to pay said claims in full.

The stock issued to Smith, together with dividends thereon, was accepted and retained by him at the date of adjudication, but it seems to be undisputed that he knew nothing of these practices of the corporation until they were discovered after the failure. Other preferred stockholders to the amount of $64,500 are in the same predicament and making the same claim against the trustee.

The old corporation and the new will be regarded as one and the same in this contest. Equity is concerned with substance [26] and not form. The old corporation being insolvent, its alleged dissolution, the filing of new articles by the same officers, directors and stockholders under identically the same name and the attempted transfer of assets was all an empty form which in equity cannot be regarded as having any greater significance than the filing of supplemental articles authorizing the issuance of preferred and common stock. With respect to the rights of Smith or any other creditor the supposed dissolution did not, in equity, occur. No advantage accrued to the corporation thereby over Smith and none to Smith over the corporation, for it seems obvious that Smith could, in a court of equity, at any time have compelled the new Morris Brothers corporation to conduct itself in strict conformance to the contract theretofore made with him by the same identical interests. There would in such case be a clear application of estoppel *in pais* operating against the corporation. If this were not the case it might be said that claimant's remedy would be against the old corporation entirely.

For this reason, the subscription having been made, the money paid, and the stock subsequently authorized, issued and accepted, the inquiry is whether it is correct to say the transaction was wholly void, either because of any question of *ultra vires* or because of the deception practiced upon the claimant. The transaction itself was

unquestionably voidable at his suit against the corporation, but did he, or does he now, hold stock that is wholly void? To take the view that he does require a holding that he never at any time acquired the status of a stockholder and could have been denied, even by the corporation itself, participation in any of the dividends declared and payable upon preferred stock.

The correct solution of what Smith's rights and liabilities would be in a suit by the trustee to collect on his subscription [27] or contract with the corporation, assuming he had not paid before bankruptcy, ought accurately to determine what his rights are now as an alleged preferred claimant in the circumstances detailed in his claim. In other words, the prime question, above all others, is did Smith become a stockholder in the corporation at all? And it seems to me an entirely reasonable conclusion that as appertains to the corporation and its stockholders they have never been in position, since the increase of its capital stock, to hold back and resist this contract on the ground of *ultra vires*. By the increase of its capital stock the corporation acquired the power to perform and became obliged to do so, albeit at Smith's option only. This, indeed, it did by issuing and delivering the stock and paying dividends to Smith. No person, therefore, other than Smith is now in position to question his standing as a preferred stockholder in this corporation. Is Smith in such position?

On principle it would appear that unless the right to evade or repudiate the contract be reciprocal it does not exist, for it cannot happen that a contract at its inception is legal and binding as to one of the parties to it and illegal and void as to the other. Circumstances may arise to justify the release of one of the parties to a contract from performance, but this does not involve the truth that there is an abysmal distinction between a merely voidable and utterly void contract. Smith's contentions proceed upon the ground that he is not and never was bound in the premises because the contract was both fraudulent and void. In so far as the fraud is concerned he falls into fundamental error. That the purchase was induced by fraudulent representations must be conceded, but that misadventure cannot avail him anything as against the trustee in this proceeding. If fraud be the only infirmity that inheres then the trustee would be empowered to sue him in the courts and recover any balance due from [28] him to the corporation upon the contract, if there were an unpaid balance, and he could not set up as a defense the censurable conduct of those who misled him. Such is the general rule and it is the rule in this state.

Falco vs. Kaupisch Creamery Co., 42 Or. 442;
Sargent vs. American Bank & Trust Co., 80 Or. 16.

Further than this, the claimant contends that the stock issued is and was always void, and states the rule to be that:

"When a corporation takes subscriptions to unauthorized stock, such subscriptions are absolutely void, and cannot be collected against the subscriber, even though the stock is afterward authorized. If the stock be issued, it gives neither the rights nor liabilities of stockholders, and if the stock be paid for, the holder becomes a creditor for money had and received, and not a stockholder."

Citing:

14 Corpus Juris, 530;

Schierenberg vs. Stephens, 32 Mo. App. 314;

Anthony vs. Household Sewing Machine Co., 16 R. I. 571;

Scovill vs. Thayer, 105 U. S. 143;

Grangers Insurance Co. vs. Kamper, 73 Ala. 325;

Clark vs. Turner, 73 Ga. 1;

Marion Trust Company vs. Bennett, 169 Ind. 346; 82 Northeastern 782;

Kampman vs. Tarver, 87 Tex. 491;

Independent Storage Co. vs. Iowa Merc. Co., 179 N. W. 157.

Aside from the distinction that this transaction is no longer executory but has become an executed contract on both sides, an analysis of these cases does not warrant holding the stock here in question to be void. The conclusion cannot be drawn from them, or any one of them, that Smith did not take on the character, rights and liabilities of the preferred stockholder; on the contrary, there is not wanting intimation or suggestion in some of these

authorities that stock bargained for, paid for, afterward issued and accepted is good notwithstanding it was unauthorized at the time the contract was made. And there is no good reason for holding otherwise, because in this instance the bargain has been carried out exactly as made, except that the representations about the flourishing [29] condition of the corporation, its extensive and valuable assets and the alleged value of the stock proved to be grossly untrue, but which, as we have seen, can make no difference at this late day. Smith was issued preferred stock of Morris Brothers, a corporation of $1,000,000 authorized capital, $500,000 common and $500,000 preferred. That is what he agreed to buy and that is what the corporation had the ability to deliver and did deliver when delivery was actually made. There is nothing in all this that violates public policy, the sanctity of the contract with respect to Smith or the rights of other stockholders in the corporation, either common or preferred; moreover, beyond any doubt, it bound the corporation and its stockholders and consequently must have bound Smith unless he avoided the contract in an appropriate suit to rescind. It may have been, because of the fraud alleged, voidable, and doubtless was, but it was not void.

Nor do I think that Smith has traced his property. For all that appears his money may have gone anywhere but into the property now in the possession of the trustee; it may have been received and immediately paid out in due course of business; there is no showing that it was banked or

that thereupon, or at all times subsequently, the corporation had on hand such an amount to its credit. The record kept of an account designated "Morris Brothers 6's," which it is claimed related to these preferred stock transactions, was a mere bookkeeping term or device. It was buncombe, because in reality there was not such thing. And the transaction by which the corporation received from Mrs. Etheridge stock it proposed to deliver to these purchasers, in exchange for which it delivered to her negotiable bonds, was merely a manipulation of corporate assets theretofore acquired and owned by Morris Brothers, into the substance of which no attempt has been [30] made or could be made to trace Smith's money. The fact that Mrs. Etheridge, to assist in the perpetration of an alleged fraud upon Smith, fraudulently received from the corporation assets, which in equity and good conscience should have been used for the benefit of creditors and now belong to them, does not entitle Smith to those assets or impress a lien thereon in his favor unless they were originally obtained from him or constitute a definitely ascertained substitute for money obtained from him. I do not see that this has been made to appear. The Supreme Court has held in Schuyler vs. Littlefield, 232 U. S. 806, that if claimant's evidence in such a case leaves the matter of identification in doubt the doubt must be resolved in favor of the trustee, and so, the money itself being irretrievable, Smith surely has no claim upon any of the general assets of the firm

in the acquisition of which he is unable satisfactorily to show his money participated.

Certain it is that the right of a preferred stockholder to take out of the estate assets over the heads of general creditors or even to participate equally with them, must be of such strong and outstanding character as not to be involved in doubt. That is not this case.

The claim is therefore disallowed, either as general or preferred.

Dated January 12th, 1922.

A. M. CANNON,
Referee in Bankruptcy.

Filed January 12, 1922. A. M. Cannon, Referee in Bankruptcy.

Filed April 6, 1922. G. H. Marsh, Clerk. [31]

AND AFTERWARDS, to wit, on the 6th day of April, 1922, there was duly filed in said court the petition of Albert C. Smith for review of the order of the Referee disallowing claim, in words and figures as follows, to wit: [32]

In the District Court of the United States for the District of Oregon.

B—5653.

In the Matter of MORRIS BROS., INC. (a Corporation), Bankrupt.

Petition of Albert C. Smith for Review.

Comes now Albert C. Smith and by this his petition respectfully prays the above-entitled court that the decision and order entered by Honorable A. M. Cannon, Referee in the above-entitled court and cause, whereby the petition and claim of said Albert C. Smith was disallowed, and the whole of said decision and order be reviewed by the Judge of said court.

Said claimant alleges,—

That the Honorable Referee erred in not allowing said claimant a lien for the amount of said claim, as prayed in said petition, upon those certain bonds and the proceeds thereof specified in said petition, and that said Referee further erred in disallowing said claim as a valid claim against said bankrupt estate.

That the Referee erred in not holding that the purported purchase of preferred stock by plaintiff, there being no such stock authorized or in existence, was absolutely void, and further erred in holding that claimant was in fact and in law a stockholder in the above-named bankrupt corporation.

That the Referee erred in not finding that the specific bonds and the proceeds thereof, set forth in the said claim and petition, represented and constituted trust funds, *ex maleficio,* derived from fraudulent and void sales of preferred stock, and traced

into the hands of Stella M. Etheridge, thence into the hands of the trustee of said bankrupt.

ALBERT C. SMITH,
Petitioner.

I. N. SMITH,
L. A. McNARY,
JOHN W. REYNOLDS,
Attorneys for Petitioner. [33]

United States of America,
District and State of Oregon,
County of Marion.—ss.

I, Albert C. Smith, being first duly sworn, say that I am the petitioner in the foregoing petition, and that the statements therein contained are true, as I verily believe.

[Seal] ALBERT C. SMITH.

Subscribed and sworn to before me this 28th day of January, 1922.

ROLLIN K. PAGE,
Notary Public for Oregon.

My commission expires January 25, 1924.

State of Oregon,
County of Multnomah,—ss.

Due service of the within petition is hereby accepted in Multnomah County, Oregon, this 30th day of January, 1922, by receiving a copy thereof, duly certified to as such by John W. Reynolds, one of the attorneys for petitioner.

J. P. WINTER,
Attorney for Bankrupt.

Filed Jan. 30, 1922. A. M. Cannon, Referee in Bankruptcy.

Filed April 6, 1922. G. H. Marsh, Clerk. [34]

AND AFTERWARDS, to wit, on the 3d day of July, 1922, there was duly filed in said court an opinion of the Court on review of order of Referee, in words and figures as follows, to wit: [35]

In the District Court of the United States for the District of Oregon.

B—5653.

July 3, 1922.

In the Matter of MORRIS BROS., INC., Bankrupt.

Opinion on Review of Order of Referee.

I. N. SMITH, JOHN W. REYNOLDS and L. A. McNARY, all of Portland, Oregon, for Petitioner.

J. P. WINTER, Portland, Oregon, for the Trustee.

This cause comes here on review from the Referee in Bankruptcy. His finding and decree were against the petitioner, who seeks to have his claim against the bankrupt's estate adjudged to be entitled to the status of a preferred claim.

For some two years prior to the transaction with which we are immediately concerned, Albert C.

Smith, the petitioner, had been doing business with Morris Bros. Inc., in buying and dealing in bonds. In the latter part of July, 1919, a salesman of Morris Bros. approached Smith and induced him to turn over to Morris Bros. the proceeds from certain Canadian bonds then due, which he had on deposit with the company and desired it to collect, for $2,000, par value, of its preferred stock. In order to induce Smith to purchase the stock, the salesman represented to him that Morris Bros. was doing a wonderful business, that its capital stock was all paid for, and that the preferred stock would be a fine buy; also that the stock would bear six per cent interest, plus a division of the dividends after the common stock was paid off, that $500,000 of common stock was paid up, and that a like amount of the preferred stock would be issued.

On July 31, 1919, Smith accepted an interim certificate, whereby Morris Bros. agreed to deliver to him $2,000 of preferred stock of the company. This was carried until January 13, 1920, when Morris Bros. delivered to Smith and Smith accepted, in lieu of the interim certificate, a certificate purporting to represent [36] 20 shares of preferred stock. At the time this stock was delivered Morris Bros. paid Smith $66.67, being the interest on the stock to January 1, 1920, plus 1 per cent; and, by admission in the petition, petitioner received an additional sum which, together with the $66.67, aggregated $146.67, covering interest on the stock at 8 per cent from July 31, 1919, to the 1st day of

July, 1920. Smith was the holder of the stock when Morris Bros. failed, which was about the end of 1920.

At the time Smith purchased the supposed preferred stock and the interim certificate, Morris Bros. Inc., was an incorporated entity, with an authorized capital stock of $100,000, and no more. This was common stock. The corporation was wholly unauthorized to issue preferred stock of any kind. On September 6, 1919, at a special meeting of the stockholders and by a resolution thereby adopted, the corporation was declared to be dissolved and the directors were authorized and empowered to sell its business to a new corporation, bearing the same name, for the sum of one million dollars. Steps were thereupon taken for the organization of the new corporation. Articles of incorporation were executed and filed fixing the amount of capital stock at $1,000,000 consisting of 5,000 shares of common and 5,000 shares of preferred; the latter to be without voice in the management of the concern. Stock books were opened and subscriptions were made, as follows:

S. M. Etheridge, common stock, 4998 shares; preferred, 5000 shares; amount, $999,800. Forbes B. Pratt, common stock, 1 share, amount $100; and John L. Etheridge, common stock, 1 share, amount $100.

Directors were elected and by-laws adopted. Among other things sought to be accomplished was

a transfer of the assets of the old corporation to the new at a valuation of $1,000,000; the new corporation assuming and obligating itself to pay the debts and obligations of the old. The books of the new company do not [37] appear to have been written up until January 1, 1920.

By a report of Morris Bros. Inc., made to the Corporation Commissioner at Salem, Oregon, June 30, 1920, the capital stock thereof is represented to be $1,000,000 divided into 10,000 shares at $100 per share, all issued and paid up. Presumably the stock was paid up by balancing the assets of the old company against it.

In an account with Stella M. Etheridge, it appears that she is credited with certain preferred stock, ranging in amount around $102,200, and is charged with an equal amount of bonds to offset the credit. Attempt has been made to trace the specific bonds charged to her, which are represented by sales slips indicating purchases by her from the company. She is also credited with certain bonds which would indicate a purchase by the company from her. After the failure of the concern, $75,000 of these bonds were found in Tacoma, Washington, but were returned to the trustee, and something like $25,000 found in the possession of the company itself, were turned over to the trustee. At the time of the failure, there were outstanding $64,500 in amount of the preferred stock among different persons who had purchased from the company. This includes Smith's stock.

On February 21, 1919, Morris Bros. Inc., acting through John L. Etheridge, President, drew a check on the United States National Bank, payable to the bank, for $100,000. Thereupon the bank issued its cashier's check for a like amount, and this was in turn deposited with the Forest Grove National Bank to the account of Stella M. Etheridge, and was checked out soon thereafter, $99,600 to Henrietta A. Morris and $400 to Fred S. Morris. There was also diverted to the personal account of Fred S. Morris a large amount of securities.

When Morris Bros. closed its doors, the claims of the [38] general unsecured creditors aggregated in excess of $1,824,000, the greater portion of which claims was, says the accountant, "contracted naturally in the last three or four months of business, from the first of September, 1920, on."

WOLVERTON, District Judge:

Two questions are presented for consideration: First, whether petitioner's claim is to be preferred above those of the general creditors; and, second, whether his claim is to be regarded in the light of that of a general creditor and is entitled to share equally with such creditors in the distribution of the assets of the estate.

The proceeds of the bonds which were the consideration petitioner paid for the preferred stock, as Bosworth, the accountant, testified, went into the general funds of the corporation, and were used by it in the general operation of its business. That is to say, they were not segregated or set apart

into a separate fund, but went into the common property of the concern, and were probably deposited with the United States National Bank and used for buying bonds and stocks and in paying the wages of employees, rent, etc. In other words, such proceeds did not go into a separate trust fund. Petitioner has failed utterly to trace the proceeds arising from the collection of these Canadian bonds into any specific trust fund which he is now enabled to identify.

The settled rule in this jurisdiction seems to be that claimant's right to establish his trust and recover his fund depends upon his ability to prove his property in its original or substituted form in the hands of the alleged trustee. Spokane County vs. First National Bank of Spokane, 68 Fed. 979, 982. This petitioner has been unable to do. All he can say is that the proceeds of his bonds have gone into the general business of Morris Bros. Inc. They have since probably been several times turned over. They have [39] wholly and entirely lost their identity, either in the original or substituted character, and the claim is therefore not one that can be or ought to be preferred above those of the general creditors. To a like purpose, see Schuyler vs. Littlefield, Trustee of Brown & Co., 232 U. S. 707, and In re See, 209 Fed. 172.

It is strenuously insisted, however, that the bonds that found their way into the hands of Stella M. Etheridge in exchange for certain of the preferred stock of Morris Bros., Inc., and which were eventu-

ally found in Tacoma and returned to the company, constitute a segregated fund set apart and kept separate from the general property or assets of the company, and that therefore petitioner is entitled to a lien upon this fund. This contention overlooks entirely the principle upon which such a lien is predicated. These bonds that came into the hands of Stella M. Etheridge are by no means the same bonds, money or funds with which petitioner parted when he purchased the preferred stock. They were supposedly other bonds that Morris Bros. purchased or accumulated after petitioner parted with his Canadian bonds or money arising from the collection thereof, and were not that which constituted the consideration for the preferred stock that he acquired. It is not shown that the petitioner ever owned or acquired any interest in the bonds that were sold or set apart to Stella M. Etheridge, and I am aware of no principle applicable whereby he is entitled to a lien upon any of these particular bonds.

This disposes of the first contention.

Respecting the second question, it must be conceded that petitioner was induced to purchase his preferred stock through misrepresentation and fraud perpetrated by Morris Bros. Inc., its managers and agents. It is probable that the corporation was solvent immediately prior to February 21, 1919, the date when its assets were depleted by the withdrawal therefrom of $100,000 through [40] the manipulation of its president and others

concerned in the transaction. But the corporation was assuredly insolvent when petitioner purchased his preferred stock in July, 1919, and it henceforth remained insolvent until the organization of the new corporation. So was the new corporation insolvent during the entire time of its existence, or whatever existence it may be said to have had. The testimony of DeLong, the agent of Morris Bros. who sold the stock to petitioner, and who was responsible for the misrepresentations made to him and upon which he relied in making his purchase, would seem to indicate that petitioner was advised that Morris Bros. was contemplating a reorganization of the corporation and an increase of its capital stock. Among other things, DeLong testified:

> "I approached him (petitioner) and told him that the company was reorganizing, that they were expanding and increasing their business inasmuch as they expected to have additional capital. * * * I told him—I went into details with this preferred stock, told him there would be so much issued, and so on. * * * It was about the time I learned of the million dollar corporation, and I think that I told him about that. * * * At that time there had been something over $80,000 worth sold, maybe more. Q. Did you tell Mr. Smith that you had sold $80,000? A. Now, I must have told him. I would think that I did tell him. * * * Q. You told him they expected

to sell about half a million dollar's worth of preferred stock? A. That was the issue."

There can scarcely be a doubt that Morris Bros. was depending upon a reorganization of the corporation for authority to sell preferred stock. It had no such authority under the original organization, and the fact of the issuance of the interim certificate is strongly evidentiary of its purpose to promote reorganization with a view to acquiring authority to issue preferred stock. If the corporation had had the authority, it is likely it would [41] have issued the stock at once.

It is immaterial whether the reorganization was regularly formed or not, or whether it was a strictly legal entity, authorized and empowered to issue the preferred stock or to transact the business which it represented it was to engage in. It is sufficient to know that it was the second entity that was thrown into bankruptcy, that it is that entity whose assets are being now administered in the court, and it is that entity from which petitioner is holding his preferred stock and against the assets of which he is prosecuting his claim. It would, therefore, be of little avail to attempt to discuss the legality of the second so-called corporate organization. It will scarcely be questioned that the new entity, whether legally organized or not, is estopped to deny the legality of the issuance of petitioner's preferred stock. So also would it be estopped to deny its entity if proceeded against as for money had and received because of

the acquirement of petitioner's funds through misrepresentation and deceit.

The regular procedure, however, by which to recover in such a case, as for money had and received is by repudiation of the stock purchase, accompanied by notice of rescission and an offer to return whatever of value has been received by the purchaser, in order to place the corporation *in statu quo*. 14 C. J. 592. That has not been done in the case at bar. The petitioner has simply presented his claim against the estate, accompanied with a declaration of willingness on his part to do and perform whatever the Court shall deem equitable in the matter of restoration of dividends paid on the stock and received by him. However, as it is not apparent that petitioner had knowledge of the alleged fraud or the insolvent condition of the corporation prior to its collapse, and as there has been interposed no technical insistence [42] upon a strict compliance with the practice, the matter will be laid aside, and the cause determined upon its merits.

The crucial question here presented is whether, under the facts as deducible from the evidence, the petitioner is entitled to have his claim adjudicated as one on a par with the general creditors.

The rule that should govern in a case of this character has been clearly and concisely stated, together with elaboration of the reasons that induced its promulgation, in Newton Nat. Bank vs. Newbegin, 74 Fed. 135, 140, from which I quote:

"There are obvious reasons why a shareholder of a corporation should not be released from his subscription to its capital stock after the insolvency of the company, and particularly after a proceeding has been inaugurated to liquidate its affairs, unless the case is one in which the stockholder has exercised due diligence, and in which no facts exist upon which corporate creditors can reasonably predicate an estoppel. When a corporation becomes bankrupt, the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of a creditor, is very strong, and all attempts of that kind should be viewed with suspicion. If a considerable period of time has elapsed since the subscription was made; if the subscriber has actively participated in the management of the affairs of the corporation; if there has been any want of diligence on the part of the stockholder, either in discovering the alleged fraud, or in taking steps to rescind when the fraud was discovered; and, above all, if any considerable amount of corporate indebtedness has been created since the subscription was made, which is outstanding and unpaid,—in all of these cases the right to rescind should be denied, where the attempt is not made until the corporation becomes insolvent. But if none of these conditions exist, and the proof of the alleged fraud is clear, we think that a stockholder should be permitted to rescind his sub-

scription as well after as before the company ceases to be a going concern."

See, also, Wallace vs. Bacon, 86 Fed. 553, and Lantry vs. Wallace, 97 Fed. 865.

Now, pursuing the thought as expressed by these authorities, and applying it here, it appears that practically a year and a half expired from the time petitioner purchased his stock to the time the corporation failed—a considerable period. Presumably, petitioner dealt more or less with the corporation in [43] the meanwhile. But, being misled and without knowledge of the fraud or the insolvent condition of the concern, this fact alone ought not to bar him from insisting upon his claim. Nor do I find want of diligence on petitioner's part, either in discovering the fraud or in taking steps to right the wrong, although it is probable that he was aware of the contemplated reorganization of the corporation in order to authorize issuance of preferred stock. It is, however, a fact satisfactorily proven that practically all the large indebtedness of the company now outstanding was created since petitioner obtained his interim certificate, and even since his certificate of stock was delivered to him and the interim surrendered. Under such conditions, and in pursuance of the rule, the general creditors have the superior equity.

The petitioner's claim will be allowed, but will be subordinated to the payment in full of the claims of the general creditors.

Filed July 3, 1922. G. H. Marsh, Clerk. [44]

AND AFTERWARDS, to wit, on the 7th day of August, 1922, there was duly filed in said court, an order of Court on review of the order of the Referee disallowing claim, in words and figures as follows, to wit: [45]

In the District Court of the United States for the District of Oregon.

No. B—5653.

July 3, 1922.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Order Modifying Order of Referee in Denying the Petition of Albert C. Smith.

This cause was heard by the Court upon review of the Order of A. M. Cannon, Referee in Bankruptcy herein, denying the petition and claim of Albert C. Smith for $2,000.00 and interest filed herein, the petitioner and claimant appearing by Messrs I. N. Smith, John W. Reynolds and L. A. McNary of counsel and the trustee of the bankrupt appearing by Mr. John P. Winter.

On consideration whereof it is now ordered and adjudged that the order of the Referee in disallowing and denying the claim of the petitioner as a preferred claim is hereby affirmed.

And it is further ordered, however, that the order of the said Referee in disallowing said claim entirely be and the same is hereby modified, and it is

ordered and adjudged that the petitioner's claim in the sum of $2,000.00, with interest thereon from the 31st day of July, 1919, at the rate of 6% per annum, less $146.67 be allowed, subject, however, first—to the payment in full of the claims of general creditors and all other claims filed and allowed against said estate, excepting only those of the nature of petitioner's claim, and it is further ordered that no part of petitioner's claim be paid until said other claims have been paid in full.

CHAS. E. WOLVERTON,
Judge.

Filed August 7, 1922. G. H. Marsh, Clerk. [46]

AND AFTERWARDS, to wit, on the 15th day of August, 1922, there was duly filed in said court, a petition of Albert C. Smith for appeal, in words and figures as follows, to wit: [47]

In the District Court of the United States for the District of Oregon.

IN BANKRUPTCY—No. B—5653.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Petition of Albert C. Smith for Appeal.

To the Honorable C. E. WOLVERTON, District Judge.

The above-named Albert C. Smith, claimant and

petitioner, feeling aggrieved by the decree rendered and entered in the above-entitled cause in reference to his claim and petition on the 7th day of August, A. D. 1922, does hereby appeal from said decree to the Circuit Court of Appeals for the Ninth Circuit, for the reasons set forth in the assignment of errors filed herewith, and he prays that his appeal be allowed and that citation be issued, as provided by law, and that a transcript of the record, proceedings and documents upon which said decree was based, duly authenticated, be sent to the United States Circuit Court of Appeals for the Ninth Circuit under the rules of such court in such cases made and provided.

And your petitioner further prays that the proper order relating to the required security to be required of him be made.

I. N. SMITH,
L. A. McNARY and
JOHN W. REYNOLDS,
Attorneys for Petitioner.

Appeal allowed on giving bond as required by law for the sum of $1,000.00.

Dated August 15, 1922.

CHAS. E. WOLVERTON,
Judge.

Petition of Albert C. Smith for appeal.

State of Oregon,
County of Multnomah,—ss.

Due service of the within petition of Albert C. Smith for appeal is hereby accepted in Multnomah County, Oregon, this 15th day of August, 1922, by receiving a copy thereof, duly certified to as such by John W. Reynolds, one of the attorneys for Albert C. Smith.

J. P. WINTER,
Attorney for E. C. Bronaugh, Trustee in Bankruptcy.

Filed August 15, 1922. G. H. Marsh, Clerk. [48]

AND AFTERWARDS, to wit, on the 15th day of August, 1922, there was duly filed in said court an assignment of errors, in words and figures as follows, to wit: [49]

In the District Court of the United States for the District of Oregon.

IN BANKRUPTCY—No. B—5653.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Assignment of Errors on Appeal of Albert C. Smith.

Comes now Albert C. Smith, claimant and petitioner in the above-entitled cause, and files the following assignment of errors, upon which he

will rely upon his prosecution of his appeal in the above-entitled cause from the decree made by this Honorable Court on the 7th day of August, 1922.

I.

That the United States District Court for the District of Oregon erred in not decreeing to claimant a lien for the amount of his claim against and upon the specific assets or proceeds thereof described in his claim and petition as prayed for by said claimant, and in affirming the Referee's order denying such lien.

II.

That the United States District Court for the District of Oregon erred in decreeing that the claim allowed petitioner be subordinated to the payment in full of the claims of general creditors.

WHEREUPON, appellant prays that said decree be modified, and that said District Court for the District of Oregon be ordered to enter a decree awarding appellant's claim without discrimination against appellant in favor of any claim not given priority by the bankruptcy law, and that said District Court for the District of Oregon be further ordered to enter a decree awarding a lien in favor of appellant for the amount of his claim against the specific assets prayed for in said claim and petition.

I. N. SMITH,
L. A. McNARY and
JOHN W. REYNOLDS,
Attorneys for Appellant.

Assignment of Errors on Appeal of Albert C. Smith.

State of Oregon,
County of Multnomah,—ss.

Due service of the within assignment of errors on appeal of Albert C. Smith is hereby accepted in Multnomah County, Oregon, this 15th day of August, 1922, by receiving a copy thereof, duly certified to as such by John W. Reynolds, one of the attorneys for Albert C. Smith.

J. P. WINTER,
Attorney for E. C. Bronaugh, Trustee in Bankruptcy.

Filed August 15, 1922. G. H. Marsh, Clerk. [50]

AND AFTERWARDS, to wit, on the 15th day of August, 1922, there was duly filed in said court a bond on appeal, in words and figures as follows, to wit: [51]

In the District Court of the United States for the District of Oregon.

IN BANKRUPTCY—No. B—5653.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Bond on Appeal of Albert C. Smith.

KNOW ALL MEN BY THESE PRESENTS, That we, Albert C. Smith, as principal, and A. M.

Fanning, as surety, of the County of Marion, State of Oregon, are held and firmly bound unto E. C. Bronaugh, Trustee of the estate of Morris Brothers, Inc., bankrupt, in the sum of $1,000.00, lawful money of the United States, to be paid to him and his successors as such Trustee, to which payment, well and truly to be made, we bind ourselves and each of us, jointly and severally, and each of our heirs, executors and administrators, by these presents.

Sealed with our seals and dated this 14th day of August, 1922.

WHEREAS, the above-named Albert C. Smith is prosecuting an appeal to the United States Court of Appeals of the Ninth Circuit to modify the judgment and decree of the District Court for the District of Oregon in the above-entitled cause in reference to the claim and petition of said Albert C. Smith;

NOW, THEREFORE, the condition of this obligation is such that if the above-named Albert C. Smith shall prosecute his said appeal to effect and answer all costs if he fail to make good his appeal, then this obligation shall be void; otherwise to remain in full force and effect.

ALBERT C. SMITH,
Principal.

A. M. FANNING,
Surety.

Bond on Appeal of Albert C. Smith. [52]

State of Oregon,
County of Marion,—ss.

On the 14th day of August, 1922, personally appeared before me A. M. Fanning and Albert C. Smith, respectively, known to me to be the persons described in and who duly executed the foregoing instrument as parties thereto, and respectively acknowledged, each for himself, that they executed the same as their free act and deed for the purposes therein set forth. And the said A. M. Fanning, being by me duly sworn, says that he is a resident and householder of the County of Marion, State of Oregon, and that he is worth the sum of $2,000.00 over and above his just debts and legal liability and property exempt from execution.

A. M. FANNING.
ALBERT C. SMITH.

Subscribed and sworn to before me this 14th day of August, 1922.

[Seal] ROLLIN K. PAGE,
Notary Public for Oregon.

My commission expires Jan. 25th, 1924.

The foregoing bond is approved, both as to sufficiency and form this 15th day of August, 1922.

CHAS. E. WOLVERTON,
Judge.

Bond on Appeal of Albert C. Smith.

State of Oregon,
County of Multnomah,—ss.

Due service of the within bond on appeal of Albert C. Smith is hereby accepted in Multnomah County, Oregon, this 15th day of August, 1922, by receiving a copy thereof, duly certified to as such by John W. Reynolds, one of the attorneys for Albert C. Smith.

J. P. WINTER,
Attorney for E. C. Bronaugh, Trustee in Bankruptcy.

Filed August 15, 1922. G. H. Marsh, Clerk. [53]

AND AFTERWARDS, to wit, on the 29th day of March, 1923, there was duly filed in said court a statement of the evidence, in words and figures as follows, to wit: [54]

In the District Court of the United States for the District of Oregon.

B—5653—IN BANKRUPTCY.

APPEAL OF ALBERT C. SMITH.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Statement of Evidence Under Equity Rule 75.

In the above cause Albert C. Smith, claimant, presented a claim against the above bankrupt,

which was a corporation organized, created and existing by virtue of the laws of Oregon, with its place of business at Portland, Multnomah County, arising from sale to him of certain preferred stock under the circumstances hereafter shown.

Smith claims that the sale was induced by fraud which he did not discover and which was concealed until after the bankruptcy of the above company.

The bankrupt is the second Morris Brothers, Inc., to be incorporated under the laws of Oregon. Its predecessor was organized under the same name and with a capital stock hereafter shown.

Some time in July, 1919, Smith was solicited by an agent of Morris Brothers, Inc.—the first corporation—to purchase some of its preferred stock. At that time Morris Brothers was a corporation with an authorized capital of $100,000 common stock only, and without power to sell or issue preferred stock. It was, however, represented to this claimant that the corporation had an authorized capital of $1,000,000, $500,000 of which was common stock and $500,000 preferred; that the common stock of the corporation was fully paid up with cash, bonds or other securities paid in or on hand to represent the same. Believing the representations so made, claimant agreed to purchase $2,000 of this preferred stock. He paid the corporation $2,000, being the proceeds of certain bonds owned [55] by him, then maturing, and thereupon an interim certificate was issued to him by which Morris Brothers agreed either to issue to him $2,000 preferred stock or repay to

him his money. The stock was not issued to him at that time. The interim certificate which he received is as follows:

"MORRIS BROTHERS, INC.
INTERIM CERTIFICATE. No. 838
Portland, Oregon, August 1, 1919.

"Upon the surrender of this certificate, properly endorsed, we will deliver to Mr. Albert C. Smith or order $2,000.00—Two thousand and no/100 Dollars—6% Morris Brothers, Inc., Preferred Stock Bonds due —— optional —— 19—, with —— and subsequent coupons attached, if when and as said bonds are issued and delivered to us.

"In the event said bonds shall not be issued and delivered to us, we will redeem this certificate for Two Thousand and no/100 Dollars—$2,000.00—and the interest which would have accrued on the bond since August 1st, 1919, but such interest will cease thirty days after we transmit notice to the above-named holder that the bonds will not be issued.

[Seal] "By JOHN L. ETHERIDGE,
"Treasurer."

Certain representations were made to Smith to induce him to enter the transaction. Smith testifies:

Testimony of Albert C. Smith.

"A. At the time the matter came up I was working for Archer & Wiggins at 6th and Oak Streets in Portland, Oregon, in the latter part of July, 1919. Mr. DeLong came down to see me one day in a friendly way and mentioned the fact that I had some bonds and they were due and if I wished I could turn them in to Morris Brothers and they would collect them."

Mr. DeLong was salesman for Morris Brothers. Following the conversation with him I studied the matter over and considered it from an investment standpoint, and then turned in my $2,000 of Canadian bonds for collection and agreed to take $2,000 of preferred stock. The understanding I had from Mr. DeLong was that their financial condition was in the very best shape. He told me it was a firm doing a wonderful business and that the company's stock was [56] all paid for and that the preferred stock would be a fine buy, better in my case than any other stock, although he said I would not have a vote. He said the preferred stock, in case of any trouble with the corporation, would be paid for first and would draw six per cent interest plus a division of the dividends after the common stock was paid off. In other words, the preferred stock would be paid at six per cent, and the common stock and the rest of the dividends divided between the common and the preferred at the same ratio.

(Testimony of Albert C. Smith.)

Q. How much common stock did he tell you was paid up? A. $500,000.

Witness continues: The preferred stock to the amount of $500,000 would be issued; that the financial condition of the corporation was better or as good as any large corporation, and it was doing a wonderful business and increasing daily. I believed and relied on these statements to a great extent, and based upon them I turned in my Canadian bonds for collection and received the preferred stock and a check for interest on the Canadian bonds. I did not get the preferred stock immediately, but did get the interim certificate which I held from July 31, 1919, to January 13, 1920.

Smith produced a letter dated Portland, Oregon, January 13, 1920, addressed to himself, signed by Morris Brothers, reading:

"We are pleased to enclose you herewith by registered mail, certificate Number 39 for 20 shares of Morris Brothers, Inc., 6% Preferred Stock. Kindly sign and return the attached receipt.

"It is agreed that the Preferred Stockholders of Morris Brothers, Inc., in case of the desire to sell this stock, shall first offer the same to John L. Etheridge, President of Morris Brothers, Inc., at $102.50 per share and accrued dividend, in view of which that, the company hereby agrees that the preferred stockholders shall participate in dividends in like amount to the common stockholders should the directors of the company declare divi-

(Testimony of Albert C. Smith.)

dends to the common stockholders in amounts exceeding six per cent.

"Knowing the favorable consideration shown Morris Brothers, Inc., by you, the directors felt that it would be binding our friendship by having you financially interested with us, and for this reason you were carefully selected by the Directors.

"With kindest personal regards from the writer and hoping you will come into the office whenever you are in the city, we are,

"Yours very truly,

"MORRIS BROTHERS, INC.

"By J. L. ETHERIDGE,

"President.

"JLE.A.

"P. S.—We will be pleased to have returned to us the interim certificate you now hold covering this stock and greatly oblige. J. L. E." [57]

And a second letter of the same date as follows:

"We take pleasure in enclosing you herewith our check for $66.67 being equivalent to a semi-annual dividend on your twenty shares of Morris Brothers, Inc., 6% Preferred Stock from July 31st, 1919, to January 1st, 1920, plus an additional 1% which is the equivalent to an additional 1% dividend, making a total of 4% from the date you purchased your stock to January 1st, 1920.

(Testimony of Albert C. Smith.)

"Thanking you for your many courtesies, we are,

"Yours very truly,
"MORRIS BROTHERS, INC.
"By ————————————,
"President.

"JLE/A."

Witness continues: Upon receipt of these letters I mailed my interim certificate to Morris Brothers, and thereafter received one dividend. At the time of taking the dividends I did not know anything about the financial condition of the company that would lead me to believe it was probably insolvent. The first I really learned that Morris Brothers, Inc., was involved financially was when it came out in the "Oregonian" December 31, 1920. I was not connected with the management of Morris Brothers in any way, held no position in the concern, and no statement of any kind was ever made to me of its true condition.

Witness then produced stock certificate 29 for thirty shares of stock, being attached to the claim of Albert C. Smith, stamped received January 24, 1921, identified it as his certificate which he turns back for cancellation, as hereinafter shown, which is as follows:

No. 39. Shares 20.

Incorporated Under the Laws of the State of Oregon.

MORRIS BROTHERS, INC.

Capital Stock $1,000,000.00, divided into Preferred Stock $500,000.00, Common Stock $500,000.00. Total number of shares 10,000, par value $100.00 each.

THIS CERTIFIES THAT ALBERT C. SMITH is the owner of twenty shares of the Preferred Stock of Morris Brothers, Inc., transferable only on the books of the corporation by the owner thereof in person or by attorney upon the surrender of this Certificate duly endorsed. This Certificate entitled the owner to receive and the Corporation is bound to pay out of any and all surplus and profits whenever ascertained, cumulative dividends thereon at the rate of six per cent per annum, payable semi-annually before any dividend shall be declared on the Common Stock. [58]

The preferred stock is subject to redemption at the rate of One hundred two dollars and fifty cents ($102.50) per share on any dividend paying date that the Board of Directors may select.

It is expressly stipulated and agreed by and between the holders of preferred stock and Morris Brothers, Inc., that the holders of preferred stock shall have no vote in the corporation.

IN WITNESS WHEREOF the said Morris Brothers, Inc., has caused this certificate to be

signed by its president and its secretary under the corporate seal this 13th day of January, 1920.

MORRIS BROTHERS, INC.
By JOHN L. ETHERIDGE,
President.
FORBES B. PRATT,
Secretary...

Shares $100 each.
Corporate Seal.

Testimony of——De Long.

Witness DE LONG, a witness for claimant, to whom Smith refers, testified that for some considerable time prior to 1919 he was a salesman for Morris Brothers. He then occupied the premises on Stark Street between Fifth and Sixth; that he solicited customers for preferred stock of Morris Brothers, and made representations upon information from Mr. Etheridge himself; that he remembered making sales of preferred stock to claimant Smith; he had known Smith two or three years prior to this sale.

Witness continues:

"A. As I recollect now I approached Mr. Smith and told him that the institution was issuing some preferred stock, and they were revising and enlarging their business and needed some outside capital. I don't know, but I may have given him a historical sketch of the institution as to how it was founded, its growth and development, and a statement of the sales as they were at the time I became associated with the institution, which was about the same time Mr. Etheridge became associ-

(Testimony of —— De Long.)

ated with it over in the Railway Exchange Building: the amount of the sales at that time and how they had grown ('Grown' did not refer to sales of preferred stock but to sales in general) . . . Then I gave him a statement or told him rather what this preferred stock was to be. It was to be part of a million dollar corporation and half was to be preferred stock and half common stock, as I recollect it. The preferred stock was to be $100 and the common $250. . . . One hundred thousand preferred and two hundred and fifty common was the original plan, but later on I was told it was to be half a million dollars, and then just shortly before I closed my selling of the preferred stock there was information that it was to be a million dollar corporation. I told this to Mr. Smith, I think." [59]

Witness continues: It was in 1919 that I closed the deal with Smith. I was closing the campaign, —but really no campaign was carried on, it was just selling intermittently from the time it was first started, towards the last that was sold. I had told him that the company had always paid a fair dividend but that the preferred stock they were selling then would likely be better than six per cent, undoubtedly would be around seven to eight per cent and possibly more. That it would be a six per cent certificate, that that is what they would guarantee on the face of the certificate. I am not clear as to what I told him in reference to the amount of common stock paid up. At first it was

(Testimony of —— De Long.)

to be a $350,000 corporation divided into $100,000 preferred and $250,000 common. I may not be correct as to this amount, but it was gradually increased later on to half a million dollars, I was told, and still later, to the million dollar corporation. That was in the summer of 1919. I had no knowledge of a million dollar corporation until late in the summer.

Q. What, if anything, did you say to Mr. Smith in reference to the form in which this common stock that was paid up existed?

A. I do not know that I can recall what I told him about that. I presume I told him it was paid up but I cannot tell you definitely as I do not recollect.

Q. Do you remember whether anything was said by you at that time as to the amount of property that Morris Brothers, Inc., had?

A. I undoubtedly told him as I told other people, that whatever money they had was invested in bonds that they had been buying for a number of years, municipal and other satisfactory bonds, which they had been buying for a number of years, and what money they had invested in their plant, the fixtures and so forth, and the lease I presume I mentioned that too. I no doubt told him that they did not own the building, but that they had a ninety-nine year lease on it at a rental of about $500 a month which was tantamount to owning the building, although they did not own the prop-

(Testimony of —— De Long.)

erty outright. Otherwise there was nothing that their capital stock was invested in.

Stating the representations which the witness made about the preferred stock, witness says: [60]

A. Yes, the preferred stock was not to have any voting power until after they had passed one or two dividends, I believe it was two, at which time they would be allowed to participate and note the same as the common stock, there was some advantage there, the advantage was over the common stock. I do not remember exactly the preferred stock was preferred as to assets and as to dividends over the common stock, that first out of the earnings there would be paid the expenses and then six per cent would be set aside for the dividends on the preferred stock and after that six per cent was to be paid to the common stockholders. After these two amounts had been taken out and set aside whatever was left, if there was anything left, it would be prorated share and share alike among all the stock, common and preferred. The certificates did not cover that.

Witness testifying about his statements to Mr. Smith and to other preferred stockholders, in reference to the financial condition of Morris Brothers as to whether it was *dound* or not, says:

A. About as near as I can answer that question is to say, that I said the assets of the institution consisted of municipal and Government bonds, that their funds were invested in that other than what was invested in their plant and equipment. I told

(Testimony of —— De Long.)

them where the fixtures came from, the old United States Bank Building, and that had a lot of money invested in the fixtures and safe deposit vaults, and other than that they had no money invested in property to my knowledge; that they did not own the building but had a ninety-nine year lease on it and I was informed that the rental was $500 a month. I will say this that what I told Mr. Smith was undoubtedly about the same as I told other people with whom I had up the matter of buying preferred stock. All I was aiming at was this, that was what was in my mind all the time and I know that must have been the impression I left with Mr. Smith regardless of what particular words I used, that the institution was a fine institution to be connected with or associated with. I know I must have left that impression with him, whatever I said, but as to the statement that the institution was solvent or a sound institution, as to the words themselves, I am sure that I did not use those words, for this reason, that I do not think that as a salesman when I came to selling stock to anyone that I would use those words. I would not want to bring up the question as to its solvency. I know that was not in my mind, but I know that I did try to leave in the minds of the people with whom I was doing business that I was connected with a fine institution.

Witness continues: I say the information came from Mr. John L. Etheridge, President of Morris Brothers. He was manager of the company at

(Testimony of —— De Long.)
that time. He was the only one I recognized as having any authority. I had no means of information myself as to the [61] institution, concerning its assets, financial condition, organization, stock, etc., outside of what Mr. Etheridge told me. I had no access to the books and records at all, and no one else seemed to know anything about it.

On cross-examination the witness says: I believed everything I said to be true. I might have talked with Mr. Smith more than once about his buying the preferred stock. At first I understood the corporation would have $250,000 worth of common stock and $100,000 of preferred, but later it was to be half a million, I think. I got the information that the corporation would have half a million worth of stock, I should judge, early in 1919, and I got the impression that it would be a million dollar corporation after the middle of the year. I cannot say that was before or after I got Mr. Smith's subscription; it was along about that time that I was informed it was going to be a million dollar corporation and the stock would be divided fifty-fifty. I told Smith the common stock was paid. My information was that it was paid. I came with the company the fore part of the year 1917, about the same time Mr. Etheridge did, and first sold preferred stock in this company in the latter part of 1918.

Witness further testifies:

(Testimony of —— De Long.)

Q. Now, just repeat the conversation you had with Mr. Smith.

A. Well, as I said I cannot repeat the words that I used.

Q. Repeat the substance of it then.

A. I approached him and told him that the company was reorganizing, that they were expanding and increasing their business inasmuch as they expected to have additional capital.

Q. In regard to that you had personal knowledge of the company and knew that they were increasing their business and their stock?

A. Yes.

Q. You knew that personally? A. Yes.

Q. You knew that to be a fact? A. Yes.

Q. What else did you tell him?

A. I told him—I went into details with this preferred stock, told him there would be so much issued, and so on. [62]

Q. Did you tell him how much would be issued?

A. I must have told him how much would be issued.

Q. What did you tell him in regard to that?

A. As to how much would be issued?

Q. Yes.

A. It was about the time I learned of the million dollar corporation and I think that I told him about that.

Q. Did you tell him how much preferred stock was sold?

A. Well I don't know whether I did or not.

(Testimony of —— De Long.)

Q. How much was sold; did you know how much had been sold at that time?

A. At that time there had been something over 80,000 dollars worth sold, maybe more.

Q. Did you tell Mr. Smith that you had sold $80,000?

A. Now, I must have told him. I would think that I did tell him.

Q. You now remember that you expected to sell about $420,000 more? A. No, I did not.

Q. You told them they expected to sell about half a million dollars worth of preferred stock?

A. That was the issue.

Q. You say you had sold about $80,000 at that time, at the time he subscribed? A. Yes.

Q. What did you tell him about that?

A. Well I told him the amout of business the institution had done and how it had increased since I became associated with it in 1917.

Q. What did you tell him about that?

A. Told him they were doing about $200,000 a month approximately at that time and at this time I was talking to him their sales had increased up to a million, or between one and two millions, I have forgotten the figures.

Q. Where did you get the information about the $200,000 a month when you came there?

A. That is what I was told.

Q. You had no personal knowledge of that fact?

A. No, I had not.

(Testimony of —— De Long.)

Q. Didn't know whether that was true or not?

A. All I knew about it was that I was given a statement to that effect.

Q. Who gave you that statement?

A. Mr. Etheridge.

Q. You told him at the time you took his subscription you were doing how much business?

A. I do not recollect, a million or a million and a half a month. Whatever the statement showed.

Q. You do not recollect?

A. It was over a million and less than two million that they were doing at that time.

Q. What else?

A. I told him this stock was to be preferred as to the assets and liabilities over the common stock, that first there was to be set aside after the expenses were paid six per cent dividend for the preferred stock and after that the common and then what was left was to be divided between the preferred and common share and share alike; that after the second dividend was not paid on the preferred the preferred stockholders were to be given a vote with the common. The preferred could not be called [63] before five years so that he knew he would have his money out at 5% at least for five years. I told him that the institution had always paid fair dividends and that in all probability it would pay considerably more than six per cent, but that six per cent would be guaranteed. I told him after

(Testimony of —— De Long.)

five years they would have the privilege of calling the stock in at $105. I told him that if he was in a position to make this investment that the government income tax would be refunded to him by the company so that it would be the same as exempt from income tax. I offered to take in some bonds he had, I have forgotten what they were, as payment for the stock just as cash.

Q. Did you tell him anything else?

A. Well, I don't know just what else I did tell him. As I have said before I left the impression with him that the institution was a good institution, that the money of the company was invested in good securities, municipal bonds and so on, securities which were undoubtedly safe, and their fixtures and lease. I know that I tried to leave the impression with him that it was in first class condition as to being a good institution in which to make the investment.

Testimony of Albert C. Smith.

Claimant SMITH states that at the time Mr. De Long talked with him about the purchase of stock De Long told him that the assets of the firm were composed of bonds and fixtures and the lease on the building, which he said were the same as cash, that is that it was good security; he said the value of the assets was supposed to be about $500,000 all in stock.

Witness continues:

In September, 1919, a new corporation was form-

(Testimony of Albert C. Smith.)

ed under the laws of Oregon with its principal place of business at Portland, Oregon; with the identical name of the original corporation, the new corporation having an authorized capital of $1,000,000, of which $500,000 was common stock, and $500,000 was preferred stock. All, or substantially all, of this stock was subscribed by one of the stockholders of the old corporation. That institution went through the form of transferring to the new corporation all of its assets in payment of the stock so subscribed and thereupon the stock of the new corporation, both preferred and common, was issued to Stella M. Etheridge, who had subscribed for the same, she being the wife of John L. Etheridge, president [64] and manager of said old corporation. There was issued to John L. Etheridge and one Pratt sufficient of this stock to qualify them as stockholders and officers of the new corporation.

On July 31, 1919, Smith accepted an interim certificate, whereby Morris Brothers agreed to deliver to him $2000 of preferred stock of the company. This was carried until January 13, 1920, when Morris Brothers delivered to Smith and Smith accepted in lieu of the interim certificate a certificate purporting to represent twenty shares of preferred stock. At the time this stock was delivered Morris Brothers paid Smith $66.67, being the interest on the stock to January 1, 1920, plus 1 per cent, and, by admission in the petition, petitioner received an additional sum which, to-

(Testimony of Albert C. Smith.)

gether with the $66.67, aggregated $146.67, covering interest on the stock at 8 per cent from July 31, 1919, to the 1st day of July, 1920. Smith was the holder of the stock when Morris Brothers failed, which was about the end of 1920.

On September 6, 1919, at a special meeting of the stockholders and by a resolution thereby adopted, the corporation was declared to be dissolved and the directors were authorized and empowered to sell its business to a new corporation, bearing the same name, for the sum of one million dollars. Steps were thereupon taken for the organization of the new corporation. Articles of incorporation were executed and filed fixing the amount of capital stock at $1,000,000, consisting of 5000 shares of common and 5000 shares of preferred; the latter to be without voice in the management of the concern. Stock books were opened and subscriptions were made as follows:

S. M. Etheridge, common stock, 4998 shares; preferred, 5000 shares, amount $999,800. Forbes B. Pratt, common stock, 1 share, amount $100; and John L. Etheridge, common stock, 1 share, amount $100. [65]

Directors were elected and by-laws adopted. Among other things sought to be accomplished was a transfer of the assets of the old corporation to the new at a valuation of $1,000,000; the new corporation assuming and obligating itself to pay the debts and obligations of the old. The books of the

(Testimony of Albert C. Smith.)

new company do not appear to have been written up until January 1, 1920.

By a report of Morris Brothers, Inc., made to the Corporation Commissioner at Salem, Oregon, June 30, 1920, the capital stock thereof is represented to be $1,000,000, divided into 10,000 shares at $100 per share, all issued as paid up.

The original stock subscription of Stella M. Etheridge and John L. Etheridge and Forbes B. Pratt to the new Morris Brothers, Inc., were never paid in any other way than by the transfer of the assets from the old Morris Brothers, Inc., to the new company.

The business of the new company was carried in the books of the old company up to about January 1, 1920. There is an account on the books showing all sales of preferred stock, heading of the account being "Morris Brothers Preferred Sixes." Mrs. Etheridge is credited with $102,200 proceeds realized from the sale of preferred stock, and on the other hand is charged with an equal amount of bonds taken by her to satisfy this credit. Smith claims a lien upon these bonds.

After the failure of the concern, $75,000 of these bonds were found in Tacoma, Washington, but were returned to the trustee, and $25,000 found in the possession of the company itself, were turned over to the trustee. At the time of the failure there were outstanding $64,500 in amount of the preferred stock among different persons who had

(Testimony of Albert C. Smith.)

purchased from the company. This includes Smith's stock. [66]

On February 21, 1919, Morris Brothers, Inc., acting through John L. Etheridge, President, drew a check on the United States National Bank for $100,000. Thereupon the Bank issued its cashier's check for a like amount, and this was in turn deposited with the Forest Grove National Bank to the account of Stella M. Etheridge, and was checked out soon thereafter, $99,600 to Henrietta A. Morris and $400 to Fred S. Morris. There was also diverted to the personal account of Fred S. Morris a large amount of securities.

When Morris Brothers closed its doors, the claims of the general unsecured creditors aggregated in excess of $1,824,000, the greater portion of which claims was, says the accountant, "contracted naturally in the last three or four months of business, from the first of September, 1920, on."

Testimony of Accountant Bosworth.

Accountant BOSWORTH, a witness for claimant, on cross-examination, says:

Q. Have you personally checked or examined all of the books and the different entries pertaining to the preferred stock that was issued by Morris Brothers? A. I have.

Q. Will you state to the Court the amount of preferred stock now outstanding?

A. My recollection is outside of the amount to

(Testimony of —— Bosworth.)

be owned by Stella M. Etheridge, $64,500 par value.

Q. Can you refer to your books and give the Court when that stock was paid for?

A. The sale of preferred stock is evidenced by interim started November 1, 1918.

Q. When was Mr. Smith's preferred stock paid for?

A. He bought an interim for preferred stock July 31, 1919.

Q. Can you tell what he paid for it? A. $2,000.

Q. To whom was this paid? [67]

A. The entry shows it was taken into the account of Morris Brothers.

Q. Do you know whether this money was used by Morris Brothers in the general course of business? A. It undoubtedly was.

Q. From the examination of the books you have made?

Mr. SMITH.—We object to the question in the form in which it is put. We would have no objection to the witness attempting to show how the cash account treated it.

Mr. WINTER.—This is an expert witness.

Objection overruled.

A. The amount received from Mr. Smith went into the general funds of the corporation, and used by them in their general operations.

Q. What do you mean by general operations?

(Testimony of —— Bosworth.)

A. I mean not segregated into a fund by itself but went into the common fund and was probably deposited in the United States National Bank and used by them for buying bonds, stocks, paying wages, rent, etc. In other words, it did not go into a trust fund, if that is what you are trying to get at.

Q. Will you turn to the entry of Mrs. Etheridge where she was given credit for $102,200 in the ledger; what is the date of that entry?

A. The heading of the account shows "1920" and the column that carries the day of the month shows "12." There is no entry showing the month. Other evidence though, from the journal, will show it was January 12th.

Q. January 12, 1920? A. Yes.

Q. You may state whether this entry is true or fictitious?

A. It is apparently a fictitious entry.

Q. In what respect?

Mr. REYNOLDS.—We object to that.

Mr. WINTER.—We have a right to ask him about his report. [68]

Mr. REYNOLDS.—We object to the question and the answer and move it be stricken out for the reason it does not appear in what way the answer can apply, whether the fact is not true or whether the entry is a forgery.

Mr. WINTER.—Fictitious, not a forgery.

The REFEREE.—If it is fictitious it is not a true entry, and you will have to inquire into that.

(Testimony of —— Bosworth.)

Q. Why do you state it is fictitious instead of being a true entry?

A. My reason may be for several reasons. In the first place my examination of the books does not show that anything was ever paid for the preferred stock by her. I find no record of any payment by her.

Q. Have you examined the records of Morris Brothers carefully to find out whether Mrs. Etheridge ever paid anything for this preferred stock?

A. I did in all places.

Q. And you discovered no such entry?

A. I discovered no such entry.

Q. At the time this preferred stock was issued to Stella M. Etheridge you may state whether or not Morris Brothers at that time was solvent or insolvent?

A. That is you want my expert opinion?

Q. Yes.

A. They were insolvent.

Q. They were insolvent at the time? A. Yes.

Q. You may state if you can from your examination of the books whether or not you were able to ascertain whether Morris Brothers were insolvent on July 31st when Mr. Smith bought his preferred stock?

A. I would say they were insolvent at that time.

Q. You think they were?

A. I think they were.

Q. Did the corporation ever receive payment for

(Testimony of —— Bosworth.)

the preferred stock issued to Mr. Smith except what was received from Mr. Smith? [69]

A. Not that I ever found.

Q. If it had received payment would not you have discovered that fact in your examination of the books? A. I would.

Q. What compensation, if any, did Morris Brothers receive for the check for $100,000 which was drawn on the U. S. National Bank and which was afterwards sent down to the bank at Forest Grove? A. Nothing.

Q. From where was this $100,000 taken?

A. From the United States National Bank.

Q. Was that a deposit?

A. That was a portion of their deposit with the United States National Bank and withdrawn from that deposit.

Q. What compensation, if any, did Morris Brothers ever receive for any bonds that they apparently sold to Mrs. Etheridge? A. None.

Q. No consideration was ever paid by Mrs. Etheridge for these bonds?

A. No true consideration. No consideration in the form of a valid payment. Nothing but a book entry.

Q. Then as to the books of Morris Brothers showing that Mrs. Etheridge purchased $100,000 worth of bonds, that is not true?

A. The books show that they were paid for but the entry is fictitious.

(Testimony of —— Bosworth.)

Q. The fact is they were not paid for?

A. Yes, not by her.

Q. Were they paid for by anybody except by Morris Brothers when they bought them?

A. That is all.

Q. These bonds according to the books that were sold to Mrs. Etheridge were the property of Morris Brothers? A. Yes.

Q. And had been all paid for by Morris Brothers in the ordinary course of business?

A. Yes, that is right.

Q. And afterwards when they were turned over to Mrs. Etheridge Morris Brothers received nothing for them? A. That is right. [70]

Q. What compensation, if any, did Morris Brothers ever receive for the check of $24,800—to whom was that check made?

A. To Henrietta A. Morris.

Q. What did Morris Brothers receive for that check? A. Nothing.

Q. The books as I recall show and as you have testified show that this $100,000 sent down to the bank at Forest Grove—

A. Yes, it was sent down to the bank at Forest Grove.

Q. What became of that?

A. The charge to the Forest Grove National Bank continued on the books until December 31, 1919, and on the opening of the new ledger in 1920 it disappeared.

(Testimony of —— Bosworth.)

Q. What became of the money?

A. That was sent down to the Forest Grove National Bank—do you want me to testify to my personal knowledge?

Q. Yes.

A. I went to the Forest Grove National Bank and found a cashier's check issued to the Forest Grove National Bank had been deposited with that bank the check being accompanied by a letter signed by Morris Brothers by John L. Etheridge directing that this $100,000 be placed to the credit of Stella M. Etheridge and that she was drawing it out at once, and that they took this course because they did not want the local banks to know their action.

Q. It was actually deposited and afterwards withdrawn?

A. It was actually deposited to the credit of Stella M. Etheridge and thereafter withdrawn.

Q. How was it withdrawn?

A. Two checks, one for $99,600 and the other check for $400.

Q. And the check for $99,600 was in favor of Henrietta A. Morris as you have already stated?

A. Yes.

Q. What compensation, if any, did Morris Brothers ever receive for the check of $99,600 that was delivered to Henrietta A. Morris? [71]

A. What compensation?

Q. What did Morris Brothers receive for this check that was turned over to Henrietta A. Morris?

(Testimony of —— Bosworth.)

A. This money was deposited in the Forest Grove National Bank and was no longer in the control of Morris Brothers.

Q. Did Morris Brothers ever receive anything for it? A. No.

Q. What became of this check?

A. It was redeposited with Morris Brothers, Inc., by which she received credit for $99,600.

Q. Who? A. Henrietta A. Morris.

Q. Does that still exist?

A. That particular account is now balanced.

Q. What did Henrietta A. Morris receive for the check of $99,600 that she deposited with Morris Brothers?

A. She received Liberty Bonds to the amount of $74,985.46 and a check of Morris Brothers in her favor for the difference between that amount and the $99,600.

Q. They got their own money back?

A. In that way.

Q. They got their own money back before, so that the result is that ultimately Morris Brothers turned over to Henrietta A. Morris Liberty Bonds and a check totalling $99,600 and obtained nothing for it whatsoever.

There is no controversy over the fact, but it is admitted, that during all of this time both the old corporation and the new corporation were insolvent and the new corporation was in a continuous state of insolvency from the time of its organization to the date of its adjudication in bankruptcy; also

(Testimony of —— Bosworth.)

that subsequent both to the time Smith made his purchase and to the time the stock was issued to him the new corporation accumulated obligations in a large amount, totalling at the date of adjudication more than $1,500,000, claims for which, general and preferred, have been filed in this court. The assets are not sufficient to pay said claims in full. [72]

The stock issued to Smith, together with dividends thereon, was accepted and retained by him at the date of adjudication, but it is undisputed that he knew nothing of these practices of the corporation until they were discovered after the failure. Other preferred stockholders to the amount of about $64,500 are similarly situated and are asserting their claims against the trustee.

There is no evidence to show that any creditor of the corporation knew of the transactions by which Smith received the preferred stock, or of his holding preferred stock, until after the bankruptcy.

The company's report to the state gave capital stock as $500,000 common and $500,000 preferred, all fully paid; and its stationery and advertising showed capital $1,000,000.

The stockholders of the new corporation at its organization were the same persons as the stockholders of the old at its dissolution.

The other purchasers of preferred stock gave testimony showing representations made to them of like import as those made to induce Smith to purchase. The statements made to them were

(Testimony of Albert C. Smith.)

made by John L. Etheridge, President of the corporation, direct.

OFFER OF CANCELLATION.

The record contains the following testimony and proceedings and none other on the offer of claimant to surrender his purported certificate of preferred stock for cancellation and for such relief as is proper.

Testimony of Albert C. Smith.

Witness and claimant ALBERT C. SMITH, on direct examination, says:

I tender my alleged preferred stock for cancellation in this proceeding to have the money paid, and am ready to return the money paid me or have it paid. [73]

Q. The certificate of stock which I now hand you and which is attached to your original claim as presented was the stock you received from this concern? A. Yes.

Q. Certificate No. 39 for twenty shares of stock, and this is the certificate we offer back for cancellation, the certificate attached to the claim of Albert C. Smith, stamped received January 24, 1921, but not signed, and it is also stamped "Ans'd." Let the record show that that was produced from the custody of the referee. Is that true, Mr. Smith?

Mr. WINTER.—I don't know about that. I don't understand that.

Mr. SMITH.—This is produced from the custody of the Referee.

(Testimony of Albert C. Smith.)

Mr. WINTER.—All right.

Q. Now, answer my question.

A. What is the question?

Q. Is that the certificate you tender back for cancellation? A. Yes

Mr. SMITH.—I offer this certificate in evidence and ask that it be marked.

Said certificate was thereupon marked Claimant's Exhibit 3.

"Mr. WINTER.—It is admitted that if Albert C. Smith was on the witness-stand he would testify that he was and is able to repay to the trustee anything that he has received on his preferred stock by way of dividends."

Judge WOLVERTON held on appeal: "The regular procedure, however, by which to recover in such a case, as for money had and received, is by repudiation of the stock purchase, accompanied by notice of rescission and an offer to return whatever of value has been received by the purchaser, in order to place the corporation *in statu quo.* 14 C. J. 592. That has not been done in the case at bar. The petitioner has simply [74] presented his claim against the estate, accompanied with a declaration of willingness on his part to do and perform whatever the court shall deem equitable in the matter of restoration of dividends paid on the stock and received by him. However, as it is not apparent that petitioner had knowledge of the alleged fraud or the insolvent condition of the corporation prior to its collapse, and as there has

(Testimony of —— Bosworth.)

been interposed no technical insistence upon a strict compliance with the practice, the matter will be laid aside and the cause determined upon its merits.

APPELLANT ASSERTS A PRIOR CLAIM ON CERTAIN BONDS.

Testimony of —— Bosworth.

Witness BOSWORTH, for claimant, on direct examination says:

I have accessible here the account in the trade account ledger in the name of Morris Brothers preferred sixes. This account represents moneys received from the sale on interims of Morris Brothers preferred six per cent stock. It shows that through preferred stock sales these various amounts as listed in the ledger have been received and shows their credit to Morris Brothers preferred stock. This large ledger I can say consists of accounts of various issues of bonds and stocks. and if Morris Brothers bought an issue of bonds, on one side of the account was set up the value of the bonds that they purchased, and on the other side, the right hand side, was set up the sales as they were made from time to time. In this case, the right hand shows the sales of Morris Brothers preferred stock and the dates of the sales and was carried in their trade account as they carried the account of other securities in which they dealt. This account shows sales from November 1, 1919,

(Testimony of —— Bosworth.)

to apparently the last sale October 16, 1919, and at November 1, 1919, they were apparently oversold two thousand at that time. I might explain that. I will have to change my desk—(*sic,* testimony)—a little on that. I beg your pardon, the last sale of preferred stock to the public—I suppose that is the date Mr. Reynolds wants—[75] was apparently January 12th or possibly January 23d. I could not tell without referring to their records of 1920.

With reference to that there is a sale here for $600 and a debit on the date following, January 13th. Later than January 12th, the items that appear, there is another for $50 on January 23d on the credit side, and $100 on the debit side of the same date.

On November 1, 1919, the amount sold and outstanding appears to be $112,500.

"Mr. WINTER.—What is that—money?

A. Money. On November 3 an offsetting item of $10,000 brought it down to $102,250 at the end of November."

Witness continues: Eliminating these items of $50 and $600 on the credit side and of $100 on the debit side, the net proceeds which were credited to this preferred stock account at that time is $102,200. Referring to the debit side of the account, the other items appear on January 12th and there is a debit item of $102,200.

Q. What entry does that represent and what

(Testimony of —— Bosworth.)

transaction is shown by the further books of the company?

A. By reference to the journals of the corporation on page 103, cash book and journal of Morris Brothers, Inc., on January 12, there appears an entry crediting the account of Stella M. Etheridge with $102,200 and debiting drawing account with $102,200, with the notation purchase bill 11251 to 11295 inclusive Morris Brothers, Inc., preferred stock.

Witness continues: Q. What then, Mr. Bosworth, does this apparently represent from a bookkeeper's interpretation?

Mr. WINTER.—If the witness can answer that.

A. Apparently it represents a transfer of a credit from one account [76] to another.

Q. And the credit referred to is the credit in the trade account ledger of Morris Brothers sixes of the $102,200 then appearing to be standing to the credit of that account by sales of preferred stock, does it not?

A. I have answered that question in my answer to the last question I think. It is the transfer of an account then and there appearing in the trade account of Morris Brothers sixes to the account of Stella M. Etheridge.

Witness continues: In that journal entry in which this transfer is made and representing this transfer is a reference to purchases from Stella M. Etheridge of preferred stock.

(Testimony of —— Bosworth.)

"Q. Referring to the date of issuance of the original certificate for preferred stock to Stella M. Etheridge, that date was January 12, was it not?

A. Preferred stock, December 1, 1919.

Q. Then on what date was the certificate cancelled?

A. There is no mark to indicate on what date it was cancelled."

Witness continues: The stock certificate book shows the turning back by Stella M. Etheridge of preferred stock in blank January 10, 1920; that is, certificate No. 1 on the January 10, 1920; there appears on the stub of certificate No. 2, issuance to Elias A. Johnson of 100 shares, but there is no memorandum showing from whom the transfer, from what stock it was transferred—that is the same date as the other certificate.

Witness continues: Explaining the reissuance of these certificates—on certificate No. 1 preferred stock, the total documentary stamps attached amount to $250, on the certificate $100. These were cancelled on the stub by C. P. Deputy Coll. On the documentary stamps on the certificate the date is merely used as a cancelling mark and no initials or other particulars are given. This certificate No. 1 was never detached and the signature on the books [77] reads "Stella M. Etheridge," as also does receipt for the stub. There is a receipt upon the stub for certificate No. 1 preferred stock by Stella M. Etheridge. There it is.

(Testimony of —— Bosworth.)

"Q. As I understand you the first certificate of preferred stock which was issued outside of this issue of the entire amount of the certificate representing the entire amount in favor of Stella M. Etheridge was on January 10th?

Mr. WINTER.—I object to the question as leading.

A. I don't know that I understand the question exactly. This record does not show that that stock certificate was ever issued or ever detached, it does not show any revenue stamps were ever attached to it.

Q. That is certificate No. 2. When is the next transaction after the certificate No. 1 of preferred stock to Stella M. Etheridge as far as the certificate shows the date; what was the next entry in the certificate book?

A. Where there is apparently a complete transaction. Certificate No. 2 is apparently incomplete as far as the delivery was concerned.

Q. Never was endorsed, was it?

A. Never was endorsed.

Q. What is the next?

A. Certificate No. 3, five shares of preferred stock was issued to Florence J. Sims, Eugene, Oregon, January 10, 1920, receipted by her on the 17th of January, 1920.

Q. Still outstanding?

A. The certificate not attached. No documentary stamps attached to the stub.

(Testimony of —— Bosworth.)

Q. And from dates, from what period are the dates of apparent reissuance of this certificate?

A. They start with January 10th and the last issue of the preferred stock of Morris Brothers is of certificate No. 50 for five shares of preferred stock of Morris Brothers to Stella M. Etheridge dated November 19, 1920, and receipted for by her on blank date. [78]

Q. What record is there on the stub of that certificate as to the source of that stock?

A. States it was transferred from Alex W. Sims, Certificate No. 12 for five shares, five shares transferred. Certificate to A. W. Sims dated October 16, 1920, as the record shows it."

Witness continues: Mrs. Etheridge had two accounts covering the period from January 12, 1920, to November, 1920,—one in the general ledger and a drawing account, and I think she also had a trade account in the accounts receivable ledger. I have that.

Referring to the trade accounts ledger the account headed Mrs. John L. Etheridge, Portland, Oregon, with the side note "Stella M." shows certain transactions in the way of bonds and shares of preferred stock and other such matters.

Referring to the Stella M. Etheridge personal account in the general ledger, the account of Mrs. Stella M. Etheridge in the general ledger of Morris Brothers, Inc., there appears on the credit side of her account under date 1920, no month, 12th day, journal, page 103, credit of $102,200, and the ref-

(Testimony of —— Bosworth.)

erence to the same book and page at which I find the entry corresponding to $102,200.

On February 16, 1920, in the same ledger the following item appears, only one item, "1920 February 16, Journal 231, debit $102,751.18," and that is the only item on that date.

Witness continues: Referring to the book of original entries from which that item appears to be taken—the journal—in her trade account in the ledger, number one, Mrs. John L. Etheridge appears credited with the same item which I have just read, February 16, cash and journal book 231, $102,751.18. I have gone over the sales slips of the sales of bonds to Mrs. Etheridge which are the source of these entries, and these sales slips correspond with the entries in this ledger account. I have only two of the [79] sales slips. The rest are locked in the vault, but they are available if you want them. Referring to folio 15588, shown by this sales slip, it shows a sale to Stella M. Etheridge.

"Q. Now, Mr. Bosworth, you may continue and state what is shown.

A. This is a carbon copy of the original bill, sales bill of Morris Brothers indicating a sale to Stella M. Etheridge of $10,000 par value City of Victoria six per cent gold bonds at a price of 90.41. Do you want me to give a full description of these bonds?

Q. Did you state the maturity date?

A. Due March 1, 1928, together with accrued in-

(Testimony of —— Bosworth.)

terest thereon from September 1, 1919 to February 13, 1920 inclusive."

Witness continues: Another item covered by that sales slips is the sale of $15,000 par value City of Regina 6% gold bonds at 93.78 due March 1, 1923, together with accrued interest from September 13, 1919 to February 13, 1920, inclusive. Total of the sales slip items amounts to $23,787.17.

From examination of the books and accounts of Morris Brothers, it was customary in selling bonds and stocks to make out what they call sales slips. Sometimes they had what they called a pure memorandum which they used for reference purposes and that was also filed away. This is the first entry of record which is made of this transaction and the sales slips are consecutively numbered.

Referring to sales bill No. 15,589. This is apparently a carbon copy of sales bill selling to Mrs. Stella M. Etheridge $25,000 par value, carbon copy —(*sic.* Caribou County)—Idaho Road and Bridge 6% gold bonds at 107.25 together with interest accrued from January 21, 1920 to February 3, 1920 inclusive. The maturity of the $25,000 par value being as follows: $5000 due May 1, 1936, $10,000 due May 1, 1937, and $10,000 due May 1, 1938, aggregating [80] $26,991.67.

Referring to sales bill No. 15,590, carbon copy of sales bill purporting to sell to Mrs. Stella M. Etheridge $25,000 par value Teton County, Idaho, 5½% R. B. bonds at 102.20 together with accrued interest from January 1, 1920 to February 3, 1920 in-

(Testimony of —— Bosworth.)

clusive, maturity dates as follows: $5000 par value, due July 1, 1936, $10,000 due July 1, 1937, and $10,000 due July 1, 1938, total aggregating $25,-714.27.

Sales bill No. 15,591 carbon copy of sales bill—selling to Mrs. Stella M. Etheridge $25,000 par value Clarke County 5½% road bonds at 103, together with accrued interest from October 1, 1919 to February 13, 1920 inclusive; maturity date October 1, 1938, total $26,258.07.

Witness continues: I never looked for the sales slips themselves because when the bond was delivered it was filed in a date file and it would be purely a memorandum anyhow. I have never looked that up and don't know whether it is on record or not. It could be found, I suppose, possibly, according to my judgment this would be the original entry as far as the books are concerned, and the other was a preliminary memorandum only made up by the salesman or clerk notifying them he had made a sale to such and such a person for such and such a bond, and that was delivered to the bookkeeping department until the bond was delivered.

The aggregate of all these sales representing bill sales numbered from 15,588 to 15,591 is $102,751.18.

The credits which appear in the book which I am now consulting,—the first item is $102,751.18, on February 15 and 18 a credit of $2019.11. There are a number of credits if you want me to read them.

(Testimony of —— Bosworth.)

Q. What is that $2019.11?

A. There is a debit and credit for clearing the account, which is an [81] offsetting item. The same as $102,751.18, both of them offset each other.

Q. What does the account show as of August 21, 1920?

A. It shows they purchased from her certain bonds to the amount of $25,535.00.

Q. What please is the description of it?

A. It is not given here.

Q. Will you turn to sales bill 21,895.

A. I have the original, it purports to be the original of a sale to Mrs. John L. Etheridge of $25,000 par value Twin Falls County Buhl Highway district 6% bonds at par. Due January 1, 1936, together with accrued interest from July 1, 1920 to August 21, 1920, inclusive. Total sales $25,208.32.

Q. That entry corresponds in all respects with the sales slip—the entry in the ledger account corresponds with the slip you just read.

A. There is an entry in the ledger dated August 21, 1920, showing a debit to her account of $25,000 par value Twin Falls County, etc., 6%, total sales $25,208.32.

Q. What credit items appear as of August 21st?

A. $25,535, reference being made to purchase book page 154.

Q. Have you purchase book page 154?

A. That is the page in the purchase book itself.

Q. What would be the original entry correspond-

(Testimony of —— Bosworth.)

ing with the statement kept by the company of this item in the ledger?

A. The purchase bill, which are numbered consecutively, setting forth the names from whom purchased, the class of bonds, and a description of the securities purchased, the amount, price, etc. That is the original entry and then to the purchase book and from that the general ledger.

Q. Have you that bill so you can find it? [82]

A. I could find it in a very few minutes. I have the purchase bill here numbered 13,539.

Q. What is shown by that?

A. Carbon copy of purchase bill showing purchase from Mrs. John L. Etheridge of $25,000 par value Clarke County, Washington, 5½% road bonds at par, together with accrued interest from April 1st to August 21st, 1920. The total amount of the purchase bill being $25,535.

Q. What if anything does either of these bills show, or any of the records show as to this entry being an exchange?

A. The purchase bill I have before me has the word 'exchange' typed on the bottom of it. I do not recall whether the sales bill has or not. The sales bill 21,895—there is a notation on the bottom, credit by P. B. 13539 $25,535, balance due from Morris Brothers, Inc., $326.68, leaving a net balance of $25,208.32.

Q. Does that purport to be an exchange of the same Clarke County bond item represented in the sales bill 15591 for the Twin Falls bonds?

(Testimony of —— Bosworth.)

A. The numbers of the Clarke County bonds set forth in the sales bill 15,591 being the same numbers of the bonds purchased shown in purchase bill 13539 of Clarke County."

Witness continues:

"Q. In reference to these bonds appearing by the sales slips, referred to, to have been sold to Mrs. John L. Etheridge, I will ask you whether the books of the corporation show those bonds to have been paid for in other means than the use of the credit which was transferred to Mrs. Stella M. Etheridge's account from the Morris Brothers preferred six per cent, account in the trade account ledger?

Mr. WINTER.—You mean paid for by Stella M. Etheridge?

Q. Whether it appears that these bonds were paid for in any other way by her than the mere transfer of that account? [83]

A. The only entries debit and credit are those which I have recited in which it shows a transfer of a credit of $102,200 to her account which were offset by an equal amount charged of bonds. Does that answer your question?

Q. That answers the question. In reference to the account of the sales of preferred sixes to Morris Brothers in making up this credit to which you have testified before when you consulted the record, do you find that as a part of the credit for these sales of bonds there is included the sum representing the sale of preferred stock to Albert C.

(Testimony of —— Bosworth.)

Smith on the 31st day of July or the 1st day of August, or about that date in 1919?

A. I would probably or possibly might find it a little difficult to show you the account in the ledger, but I had prepared for Whitfield Whitcomb & Co. a statement of all interims issued for preferred stock which statement we were looking at yesterday, and I noticed listed a sale to Mr. Smith on the date he testified to. If desired I could run the sale down, as far as I am concerned and check my past search upon the same, but I will say that I believe that statement to be correct and it does represent a sale to him of that date.

Q. That we think is quite material for us to show unless counsel is willing to trust the witness' memory, although we would like to trace the matter down.

Mr. WINTER.—I don't know that I get your question. Your question is whether or not the credit given to Mrs. Etheridge of $102,200—whether or not that embraces the amount which Mr. Smith paid for his preferred stock?

Mr. REYNOLDS.—That is right.

Mr. WINTER.—I do not see how any bookkeeper or expert could answer that question.

The WITNESS.—I thought you asked me the question of [84] whether I was able to locate the credit that arose by reason of Mr. Smith's payment.

Q. And also to trace the credit of that amount

(Testimony of —— Bosworth.)

into this ledger account of Morris Brothers, Inc., preferred sixes.

A. The account shows and my recollection bears me out, I think, that he did purchase that number of shares on that date evidenced by interim certificate and that there was a contra-entry charging him back, but in the way of cancellation, for that amount up to the time the $102,200 entry was effective.

Q. Then based upon the original entry you referred to showing the sale to him on the interim of the $2,000 preferred stock there is a corresponding credit found in the ledger account?

A. Yes. Not in the ledger account, but in the trade account to Morris Brothers sixes. I can refer to it instantly. As I recall it the amount was $2,000 and that the sales number was 9050. Am I correct there?

Q. I am not certain of the number.

A. Just a minute (examining records). 9050 I find is a carbon copy sales-slip quoting a sale to Mr. Albert C. Smith, care Archer, Wiggins & Co., Portland, Oregon, $2,000 par value Morris Brothers, Inc. six per cent preferred stock at $2,000, and it is reflected in the corresponding entry in the trade ledger being the entry of July 31, apparently 1919, for $2,000 preferred stock par value $100, Morris Brothers, Inc. preferred sixes.

Witness continues: On answering your question as to what would be the largest total amount of

(Testimony of —— Bosworth.)

preferred stock outside of Mrs. Stella M. Etheridge personally at any time—

"A. That would be a pretty difficult thing to say offhand, except this, at that particular time the largest amount was the amount that was outstanding immediately following the issuance of the [85] preferred stock to those holding interims for preferred stock. Immediately thereafter Mr. and Mrs. Etheridge commenced apparently to buying the stock in and it decreased, and while I do not actually think there were any new purchases by anybody on the outside, I do not know of any, I think the largest amount was immediately thereafter; and the difference between the certificates that were apparently outstanding in her name or that were outstanding in her name at that time, and the total issuance of 5000 shares would give the amount. If you would like to know that, I can get it.

The REFEREE.—What difference does that make?

Mr. REYNOLDS.—We wish to connect up the way in which the preferred stock was handled, wish to show it was substituted for the original certificates for which new certificates were issued. We wish to show the process used.

A. I find certificate stub No. 47 dated January 28, 1920, and issued to Stella M. Etheridge duly receipted by her on the 31st day of January, 1920, calling for 3983 shares; the difference between that the 5000, of course, is 1017 shares; am I correct?

(Testimony of —— Bosworth.)

Q. Yes.

A. Without a close analysis of the account, however, going clear through it, I would not say the difference was all issued to somebody else, but it would be my impression that was the case.

Q. Did the balance represented by this second certificate continue outstanding in her name?

A. The certificate is not in the book.

Q. As far as the stub shows it is still outstanding.

A. Still outstanding.

Q. Do the books of account of the company or any records show any payment or purported payment of the subscription to the common stock to the new corporation except the receipt by the new corporation of the assets of the old?

A. The only entry I have been able to find on the ledger is a debit [86] item to Morris Brothers account of one million dollars which apparently took care of both preferred and common stock. There is nothing further to indicate any payment of any amount for preferred or common stock in that particular entry.

Q. What is the interpretation of that particular entry; does it purport to be on the books of the new company against the old, or was there any change in the books effective?

A. The new books were started on January 1, 1920, and certain entries and accounts appearing in the old ledger do not reappear in the new ledger. There were certain items carried forward, of course,

(Testimony of —— Bosworth.)

from one ledger to the other, but the capital stock on the old ledger appears no longer on the new ledger, and there were certain other entries, perhaps you are not interested in what don't appear. The new ledger simply has the item of $500,000 preferred stock, a credit item, $500,000 common stock, and the offsetting charge and debit item of a million dollars to Morris Brothers, Inc. or some such entry as that. That is an entry to put the books in balance.

Q. There is nothing then appearing on the new records of the books of account to show that the $500,000 in common stock subscription of Stella M. Etheridge was paid up unless it be considered paid by the new company receiving some of the assets of the old company?

A. That is correct. There is no entry showing any further addition to the capital stock or to the capital investment other than just simply a transfer of the business, and you can call it anything you want to, goodwill, fixtures, assets, and so on."

Thereupon upon redirect examination said witness gave the following testimony and none other, and the following proceedings were had and none other, touching the question under discussion:

"Q. Referring to your testimony in reference to the conclusion in [87] reference to the purchase of these bonds by Mrs. Etheridge and the payment for them by the charge against her credit arising

(Testimony of —— Bosworth.)

from the sale of the treasury stock, that this was a fictitious transaction. So far as the entries on the books are concerned, does it not appear that it was an attempt to sell the bonds to Mrs. Etheridge under the guise at least of her furnishing preferred stock to supply these interim holders?

A. If you put it that way, what they tried to make it appear, I would say possibly that was true. That their idea was to set up on the books a fact as if they had purchased from her so much of the preferred stock for which they gave her credit.

Q. In other words, if the fact had been that the preferred stock that she had subscribed for had been *bona fide* and actually paid for so that the corporation had received the real assets representing that subscription, then the entry would correspond to that sort of a transaction?

A. It might be a lawful entry from an accounting standpoint—but it would mean this, the corporation would surrender for her account in a trust fund so much money, which would later be turned over to her, and it could be done in that way.

Q. If I understand you then the basis upon which you say the entry regarded by you as fictitious is that the subscription to the stock by Mrs. Etheridge was either a dummy subscription, or at least a subscription under which it had received no value or payment.

A. Of course the subscription to the capital stock of any corporation has no value other than the willingness of the person subscribing to pay

(Testimony of —— Bosworth.)

for it, but I found no evidence she ever did pay said subscription—other than by the transfer hereinbefore referred to.

Q. And the only supposition under which that could have been paid would be the supposition that the assets of the old corporation [88] were sufficiently above its liabilities to make Mrs. Etheridge's stock in the old corporation worth the amount of her subscription in the new, would it not?

A. That would be the only theory under which you could say that that capital stock was paid because there is no evidence of any other consideration in any shape, form or manner being turned over.

Mr. SMITH.—When you examined the affairs of the corporation after the bankruptcy, did they have any cash on hand?

A. I only know by hearsay. Mr. Withington had that part in charge.

Q. Was there any?

A. Yes, there was some cash on hand I believe.

Q. How much?

A. The report would show that. I do not dare to trust my memory on a matter like cash on hand. The amount shown is $3831.00.

Q. Cash on hand here? A. In the vaults.

Q. In addition to that there was cash on hand in the bank aggregating about $300,000?

A. The bank accounts reconciled show $303,376.96.

(Testimony of —— Bosworth.)

Q. When they closed?

A. As of closing of business this date, the 24th, not the 27th.

Q. From your examination of the assets and the liabilities of the corporation was Morris Brothers Incorporated ever in a position to have declared a dividend whatsoever on their preferred stock?

A. No.

Q. You think the dividends were also fictitious?

A. They were paid out of the capital assets or out of the funds of the other people, customers of the concern, or whatever happened to be handy at the time."

On recross-examination the witness states:

The greater majority of the $303,376 in the bank at the time Morris Brothers closed their doors on December 24th was taken by the banks and applied in payment of the notes they held of Morris [89] Brothers. The banks absorbed what Morris Brothers owed them and covered practically every dollar in any bank except one or two banks they were not able to borrow from, which aggregated proximately $50,000.

"Q. How much was left in the banks that was not absorbed by the banks, if you can tell?

A. $96,183 is the amount here, which includes the cash on hand as well as in the banks."

Testimony of George T. Withington.

Thereafter witness GEORGE T. WITHINGTON was called and testified and gave the following testimony and none other, and the following proceedings were had and none other:

On Direct Examination.

In connection with my work and investigation on assets and liabilities of Morris Brothers, I found bonds in a safe deposit box in the name of Stella M. Etheridge or John L. Etheridge in connection with the transaction—there was $100,000; $75,000 discovered by the district attorney and $25,000 remained in the safe deposit box in bonds. In the safe deposit box were Twin Falls Buhl District bonds $25,000, numbered 281 to 305 inclusive. I do not know their maturity dates.

"Q. Do you know this, were these the same bonds which had, for which the books of the company indicated Mrs. Etheridge had exchanged the Clarke County Bonds which appear on a purchase slip in her favor and apparently paid for or charged to her account against the credit of the preferred stock?

A. There was an exchange took place. Of course I am not entirely satisfied that they were the same bonds, but I think they were. I know there was an exchange of the original bonds delivered to her of $100,000 but just exactly what the change consisted of I cannot recall. My impression is that it was an exchange of Twin Falls for [90] Clarke

(Testimony of George T. Withington.)

County. * * * I have a list prepared by one of our auditors for our own use—15 City of Regina, denomination $1000 * * * This only shows the denomination and serial numbers of the bonds.

Q. What are the other items?

A. $10,000 City of Victoria bonds, denomination $1000 each. $25.00 Caribou, $1000 each. $25,000 Teton County, $1000 each."

On cross-examination the witness states:

"Q. In regard to the $25,000 worth of bonds you located in a safe deposit box, just tell me about that, how they were located and all that you remember about it.

A. We were not able to get into the safe deposit box for some time. Mr. Morris had told us at frequent intervals he had a key and when it was just right he would open that box and we could see what was in it. So one evening Mr. Morris and myself and Walter Evans, the District Attorney, opened that box and listed all the securities and contents of the box and these bonds that I spoke of were among the bonds.

Q. Were there in that safe deposit box other bonds outside of the $25,000 worth?

A. Yes, I believe there were.

Q. Were those other bonds the property of Morris Brothers?

A. Not considered as such, no, sir.

Q. Not considered as such by whom?

(Testimony of George T. Withington.)

A. By myself as an auditor. They were not in the possession of the company and their value was not contained on the books.

Q. In your examination of the books subsequently did you ascertain that these other securities than the $25,000 had been taken out of the assets of Morris Brothers and had never been paid for?

A. They had been paid for in this way. The money had been transferred from the account of Morris Brothers to the account of Stella M. [91] and John L. Etheridge. They had purchased them and the check or money was derived from Morris Brothers.

Q. So as a matter of fact, the condition was that when Etheridge wanted to buy any bonds for himself he would take the money out of the assets of Morris Brothers to pay for the bonds without giving them consideration therefor, considering the bonds as his? A. Yes.

Q. As a matter of fact they always belonged to Morris Brothers? A. Yes.

Q. This money that was diverted by Etheridge, Morris Brothers received no value for it at all?

A. Received nothing for it.

Q. In regard to the $75,000 worth of bonds that were returned from Tacoma; the first time you say you located these they were in the hands of the district attorney? A. Yes, sir.

Q. Is it not true when Mr. Etheridge left here

(Testimony of George T. Withington.)

and went through Tacoma that he himself mailed these bonds back to Fred S. Morris? A. Yes.

Q. And returned them to Fred S. Morris as the property of Morris Brothers?

A. Yes. In fact, within a few hours after taking up the work of the audit, Mr. Morris explained to me personally that these bonds had been shipped by Etheridge to himself, and I was pretty badly stumped to determine what these bonds were doing over at Tacoma and how they got there. I looked at it this way, that if they had shipped $75,000 worth of bonds over to Tacoma, there might be $50,000 worth at Seattle or somewhere else. I subsequently learned the facts from John L. Etheridge himself.

Q. That they were—

A. That Mr. Etheridge was endeavoring to cover up the whole deal in this way; these sales bills and purchase bills were taken from the files and I wanted to find the source of the entry down into the books and I could not find it. After working for several days I happened to say something to Miss Agler and she told me that Mr. Etheridge [92] had frequently had them bring him some of these purchase or sale bills and then he put them away in his private vault. I wanted to know the reason and they told me at the time of state investigation they did not want to have the auditors have too much information and that is why they were removed and that is why the bonds were taken to Tacoma.

(Testimony of George T. Withington.)

Q. So they were simply taken to Tacoma, not because they were considered the personal property of Etheridge or his wife, but because they wanted to stop an investigation that was being made at the time?

A. That is the explanation given me at the time.

Q. That is the information you got not only from the books but from your other investigation of the affairs of Morris Brothers? A. Yes.

Q. Did you ever find out the true reason why the preferred stock was issued to Mrs. Etheridge and thereafter surrendered by her to the corporation?

A. I believe it was one of Mr. Etheridge's financing deals. He described that in the great number of corporations organized by Mr. Morris it was the common practice to issue common stock, say for $500,000 and throw in the preferred stock as a bonus and that is what was done in this case according to his own explanation. The preferred stock was supposed to represent a nonassessable value, something you could not attach, something incorporeal.

Q. Did you in the course of your examination of the books and affairs of Morris Brothers examine the sales slips made to Mrs. Etheridge?

A. Yes.

Q. State whether or not these are true or fictitious entries?

A. So far as the entries are concerned there is nothing fictitious about it but there is no definable or any other kind of value than the mere figures.

(Testimony of George T. Withington.)

Q. Are the figures fictitious?

A. The figures are there but they represent no value. [93]

Q. Make that clear.

A. In other words, if they put an entry through the books for $100,000 wherein that was presumed to be the consideration, and there was no consideration, you could hardly speak of it being a fictitious entry.

Q. But it is not a true story?

A. It would be lacking of consideration.

Q. It would be entirely valueless and without consideration?

A. Yes, but from the entry standpoint, from the manner in which they carried out these transactions. The entry itself would be all right as an entry but there would be no value represented by the figures.

Q. When Mrs. Stella M. Etheridge got credit for $102,200 upon the books had Morris Brothers received anything?

A. They had not received anything tangible except the right to issue preferred stock to interim holders who had bought that stock.

Q. Otherwise Morris Brothers received nothing of value for the credit which Mrs. Etheridge was getting? A. No."

Upon recross-examination the witness continues:

"Q. (Mr. WINTER.) Of the $64,500 of preferred stock, of that, now outstanding, all that

Morris Brothers ever received for that stock was what they received from the present holders?

A. In the way of the purchase of interims?

Q. Yes. A. That is all."

WHEREUPON the claimant Albert C. Smith prays that the above and foregoing statement be settled as a full, true and correct statement of the evidence upon the appeal by him, and a full, true and correct statement of all the evidence and of all the persons necessary to illustrate the points designated in this abbreviated statement of the case.

Dated December 11, 1922.

L. A. McNARY,
I. N. SMITH and
JOHN W. REYNOLDS,
Attorneys for Albert C. Smith, Claimant and Appellant. [94]

Service of the above and foregoing proposed statement of the case by appellant Albert C. Smith is admitted at Portland, Oregon, this 15th day of January, 1923.

J. P. WINTER,
Attorney for Trustee.

It is hereby stipulated and agreed by and between the attorneys for the respective parties, to wit, by the attorneys for Albert C. Smith, appellant, and by the attorney for the trustee in bankruptcy of the estate of Morris Brothers, a bankrupt, that the above and foregoing proposed statement of the case contains a full, true and correct

transcript and record of all the evidence and proceedings had at the hearing of the above cause before the Referee in Bankruptcy and on appeal to the District Court of the United States for the District of Oregon, and that the same may be signed, sealed and settled as a true, correct, full and complete statement of the case to be used on said appeal.

Dated at Portland, Oregon, this 27th day of March, 1923.

I. N. SMITH,
L. A. McNARY and
JOHN W. REYNOLDS,
Attorneys for Albert C. Smith.
J. P. WINTER,
Attorney for Trustee. [95]

Certificate of Judge to Statement of Evidence.

I, Charles E. Wolverton, Judge of the District Court of the United States for the District of Oregon, who tried the above cause, do hereby certify that the above and foregoing statement of the case contains a full, true and correct transcript of the testimony and proceedings had at the hearing on review of the decision of the Referee in the matter of Morris Brothers, Inc., a bankrupt, relating to the claim of Albert C. Smith, and that said statement contains all the records and proceedings necessary to illustrate and illuminate the various contentions of the parties on the points made by the appellant in this appeal.

I further certify that said statement of the evidence contains the proposed statement as made by appellant Albert C. Smith and all amendments thereto which were allowed.

Dated Portland, Oregon, January 29, 1923.

CHAS. E. WOLVERTON,
Judge.

Filed March 29, 1923. G. H. Marsh, Clerk. [96]

AND AFTERWARDS, to wit, on the 29th day of March, 1923, there was duly filed in said court, a praecipe for transcript, in words and figures as follows, to wit: [97]

In the District Court of the United States for the District of Oregon.

No. B—5653—IN BANKRUPTCY.

APPEAL OF ALBERT C. SMITH.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Praecipe for Transcript of Record.

To the Honorable Clerk of said Court:

Please include in the transcript of record in the above-entitled appeal the following:

1. Citation on appeal, with proof of service.
2. Petition and amended claim of Albert C. Smith.
3. Answer and objections by Trustee.
4. Decision of Referee.
5. Petition for review.

6. Opinion of District Court.
7. Judgment order of District Court.
8. Petition for appeal with order allowing same.
9. Assignment of errors.
10. Appeal bond and approval.
11. Statement of evidence.
12. All orders extending time.
13. This praecipe, with proof of service.

I. N. SMITH,
L. A. McNARY and
JOHN W. REYNOLDS,
Attorneys for Appellant.

State of Oregon,
County of Multnomah,—ss.

Due service of the within praecipe is hereby accepted in Multnomah County, Oregon, this 23d day of March, 1923, by receiving a copy thereof, duly certified to as such by John W. Reynolds, one of the attorneys for appellant.

J. P. WINTER,
Attorney for Trustee.

Filed March 29, 1923. G. H. Marsh, Clerk. [98]

Certificate of Clerk U. S. District Court to Transcript of Record.

United States of America,
District of Oregon,—ss.

I, G. H. Marsh, Clerk of the District Court of the United States for the District of Oregon, do hereby certify that the foregoing pages, numbered from 2 to 98, inclusive, constitute the transcript of

record upon appeal in a case in said court of Morris Brothers, Inc., Bankrupt, in which A. C. Smith is appellant and Earl C. Bronaugh, Trustee in Bankruptcy of the Estate of Morris Brothers, Inc., Bankrupt, is appellee; that the said transcript has been prepared by me in accordance with the praecipe for transcript filed by said appellant and is a full, true, and complete transcript of the record of proceedings had in said court in said cause in accordance with the said praecipe as the same appear of record and on file at my office and in my custody.

I further certify that the cost of the foregoing transcript is $28.60, and that the same has been paid by the said appellant.

I return, with the said transcript attached thereto, the original citation in said cause.

In testimony whereof I have hereunto set my hand and affixed the seal of said court, at Portland, in said district, this 21st day of May, 1923.

[Seal] G. H. MARSH,
Clerk. [99]

[Endorsed]: No. 4043. United States Circuit Court of Appeals for the Ninth Circuit. In the Matter of Morris Brothers, Inc., Bankrupt. Albert C. Smith, Appellant, vs. Earl C. Bronaugh, Trustee in Bankruptcy of the Estate of Morris Brothers, Inc., Bankrupt, Appellee. Transcript of Record.

Upon Appeal from the United States District Court for the District of Oregon.

Filed June 2, 1923.

F. D. MONCKTON,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

By Paul P. O'Brien,
Deputy Clerk. [100]

In the District Court of the United States for the District of Oregon.

May 24, 1923.

No. B—5653.

In the Matter of MORRIS BROTHERS, INC., Bankrupt.

Order Extending Time to and Including June 15, 1923, to File Record and Docket Cause.

Now, at this day, for good cause shown, it is ORDERED that the time within which to file the transcript of record in the above-entitled cause, on the appeal of A. C. Smith, and to docket the same in the United States Circuit Court of Appeals, be and the same is hereby extended to and including June 15, 1923.

R. S. BEAN,
Judge.

[Endorsed]: No. 4043. United States Circuit Court of Appeals for the Ninth Circuit. Order Under Subdivision 1 of Rule 16 Enlarging Time to and Including June 15, 1923, to File Record and Docket Cause. Filed June 2, 1923. F. D. Monckton, Clerk. By Paul P. O'Brien, Deputy Clerk. [101]